HERRICK, FEINSTEIN LLP'S
FIFTH ANNUAL CAPITAL MARKETS SYMPOSIUM
SEPTEMBER 22, 2011

THE DODD-FRANK ACT: THE ONE YEAR RETROSPECTIVE

THE HARVARD CLUB

HERRICK, FEINSTEIN LLP'S
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THE DODD-FRANK ACT: THE ONE YEAR RETROSPECTIVE

A distinguished panel of financial and legal experts, including representatives of **JPMorgan Securities, Inc. FTI Consulting, The Deal LLC** and **Herrick, Feinstein LLP**, will assess the current regulatory initiatives underway to implement the mandates of the Dodd-Frank Act.

KEYNOTE SPEAKER

THE HONORABLE MICHAEL E. McMAHON

FORMER U.S. CONGRESSMAN
COUNSEL TO HERRICK, FEINSTEIN LLP

SYMPOSIUM FACULTY

James E. Glassman
Managing Director and Senior Economist, JPMorgan Securities, Inc.

William J. Nolan
Senior Managing Director-Corporate Finance, FTI Consulting

Robert Teitelman
Editor-in-Chief, The Deal LLC

Stephen D. Brodie
Partner, Herrick, Feinstein LLP

Irwin M. Latner
Partner, Herrick, Feinstein LLP

Hon. Michael E. McMahon
Counsel, Herrick, Feinstein LLP

Patrick D. Sweeney
Partner, Herrick, Feinstein LLP

CONTENTS

SPEAKER BIOS 1

KEYNOTE SPEECH
THE DODD-FRANK ACT: THE ONE YEAR RETROSPECTIVE 5
By Hon. Michael E. McMahon,
Former U.S. Congressman, Counsel to Herrick, Feinstein LLP

DODD-FRANK SCORECARD MOVING FORWARD: 9
Status of Activities Required Under the Dodd-Frank Act
in the Next Several Months by the Three Major Regulatory Agencies
By Hon. Michael E. McMahon and Liliana Chang
Herrick, Feinstein LLP

THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S SLOW START AND THE DEBATE OVER BANK CAPITAL 15
By Stephen Brodie & Regina Liang
Herrick, Feinstein LLP

THE TRUTH ABOUT BANK CAPITAL 21
By Robert Teitelman
Editor-in-Chief, The Deal LLC

THE DEAL ECONOMY BLOG: TRANSACTIONS 24
By Robert Teitelman
Editor-in-Chief, The Deal LLC

ASSET-BACKED SECURITIZATION AND CREDIT RATING AGENCIES 27
By Patrick D. Sweeney and Julie Albinsky
Herrick, Feinstein LLP

HERRICK'S DODD-FRANK NEWSLETTER, SEPTEMBER 2011 56
SEC Adopts Final Investment Adviser Rules Pursuant to Dodd-Frank;
Deadline for Adviser Registration Extended to March 30, 2012

HERRICK'S DODD-FRANK CHARTS 65
A chart summarizing regulatory developments with respect to Dodd-Frank
Updated Though September 7, 2011

SPEAKER BIOS

JAMES GLASSMAN

MANAGING DIRECTOR & SENIOR ECONOMIST, JP MORGAN CHASE & CO.

Mr. James E. Glassman is a Managing Director and Senior Economist with JP Morgan Chase & Co. He works closely with the firm's chief investment officer, commercial banking, investment banking, and government relations groups. He publishes independent research on the principal forces shaping the economy and financial markets. Mr. Glassman's views are widely cited in the financial media, where he is a frequent commentator on economic policy issues. From 1979 through 1988, Mr. Glassman served in a number of areas in research divisions at the Federal Reserve Board in Washington D.C. He joined the JPMorgan Chase & Co. family in 1988. Mr. Glassman earned a bachelors degree from the University of Illinois, Champaign-Urbana, Illinois. Subsequently, he was awarded a Ph.D. in economics from Northwestern University.

WILLIAM NOLAN

SENIOR MANAGING DIRECTOR, FTI CONSULTING

Mr. Nolan has worked in all areas of corporate recovery including working with senior management in business turnarounds and corporate bankruptcy. He has over 20 years of diverse financial consulting and management experience. Mr. Nolan has considerable experience working with senior management teams in the areas of financial and operational restructuring, loan workouts and business planning. He has assisted management in developing business plans, devising financial strategies and projections for use in troubled debt restructures and implementing controls over cash expenditures, overhead and operating costs.

Mr. Nolan is one of the Firm's leading experts on the restructuring of financial services companies. Some of the recent restructurings in the financial services industry on which Mr. Nolan has been engaged include the restructuring of one of the nation's largest mortgage originators and servicers; Credit-Based Asset Servicing and Securitization (C-BASS), a large RMBS investor and loan servicer; two separate international mono-line financial guarantee insurance providers; a $10 billion international investor in real estate and real estate related non-performing loans; The Education Resources Institute, Inc., the nation's largest guarantor of private loans for education; and Refco, Inc. Other representative engagements in the financial services industry in which Mr. Nolan has been engaged include Peoples Choice Mortgage; Mortgage Lenders Network; ResMae Mortgage Corporation; First NLC; Alliance Mortgage; Mortgage Corporation of America; American Business Financial Services; Conti-Financial Corporation; Thaxton Financial; Oakwood Homes Financial Corporation; First Alliance Mortgage Company; Crimi Mae Inc; Fidelity Bond and Mortgage and others.

Mr. Nolan has written and presented on key issues in the financial services industry including publishing articles on mortgage lending topics and has co-authored a chapter in the Mortgage and Asset Backed Securities Litigation Handbook published by West Law.

Prior to joining FTI, Mr. Nolan was a partner with PricewaterhouseCoopers. Mr. Nolan holds a B.S., Economics, University of Delaware and an M.B.A., Finance, Wharton School, University of Pennsylvania.

ROBERT TEITELMAN

EDITOR IN CHIEF, THE DEAL LLC

As editor in chief and also a member of the company's executive committee, Robert Teitelman is responsible for editorial operations of The Deal LLC's print and electronic products. Bob joined The Deal in December 1998 from Institutional Investor, where he had worked since 1989, ending his tenure there as the magazine's editor in chief. In 2003 Min Magazine chose Bob as one of the "21 Most Intriguing People" in media, and in 2008 BtoB Media Business selected him as a "Top Innovator." Bob also writes The Deal Economy blog and is a participant in The Deal Economy event; he also regularly speaks on radio and television.

Bob is the author of two books, Profits of Science: The American Marriage of Business and Technology; and Gene Dreams: Wall Street, Academia, and the Rise of Biotechnology, both published by Basic Books. Bob has also worked as a writer and editor for Forbes and Financial World.

PATRICK SWEENEY

PARTNER, HERRICK, FEINSTEIN LLP

Patrick D. Sweeney is Chairperson of Herrick's Investment Management Practice Group. He represents investment managers, investment funds and investment fund fiduciaries in a wide range of corporate, regulatory and transactional matters. Pat also represents major institutional investors in corporate debt restructuring and non-U.S. investors in inbound investments.

Prior to joining Herrick, Pat practiced investment management law in-house for more than 10 years, first as senior investment counsel for Merrill Lynch Asset Management and then as General Counsel to Nomura Corporate Research and Asset Management. He began practicing law in association with Shearman & Sterling in the 1980's, where he represented financial institutions in corporate, securities and finance transactions.

Pat is an active member of the New York City Bar Investment Management Committee and the Investment Company and Investment Adviser Subcommittee of the American Bar Association's Business Law Section, and has participated for many years in committees, conferences and panel presentations of the Investment Company Institute, the Loan Syndications and Trading Association, the Mutual Fund Directors Forum and many other investment management industry organizations.

MICHAEL MCMAHON

COUNSEL, HERRICK, FEINSTEIN LLP

Michael is a former Democratic U.S. Representative for New York's 13th Congressional district, which includes all of Staten Island, plus southwest Brooklyn, including Bay Ridge.

While in Congress, Michael served on the Committee on Foreign Affairs and the Committee on Transportation and Infrastructure. He was also elected Freshman Whip by the members of his class. Michael served on the New Democrats' Financial Services Task Force. He is credited with drafting the derivatives regulatory language (HR 3300), which was adopted in Dodd-Frank; bringing billions of dollars in infrastructure improvements to New York City; introducing and passing the Iran Human Rights Sanctions Act; and founding the Invisible Wounds Caucus, which continues to focus on veterans' mental health issues. Michael is a recognized leading voice in defending our nation's financial and real estate investment companies and promoting their importance to New York's economy.

Prior to his time in Congress, Michael was a Member of the New York City Council. He was the Chairman of the Committee on Sanitation and Solid Waste Management and a Member of the Land Use and Finance Committees. While on the Council, Michael spearheaded the implementation of a new Citywide Solid Waste Management Plan, wrote numerous laws revamping the City's recycling program, and oversaw the rezoning of hundreds of properties in the City. Earlier in his career, Michael worked for State Assembly Members Eric Vitaliano and Elizabeth Connelly.

Michael has built a reputation as a pragmatic deal maker who has won support and praise from both sides of the aisle. He was endorsed multiple times for reelection by Mayors Bloomberg and Koch, Governor Cuomo, as well as the Conservative/Republican Borough President of Staten Island, James Molinaro.

Prior to being elected to public office, Michael was a partner at the law firm of O'Leary, McMahon & Spero in Staten Island. He obtained his B.A. from New York University and his J.D. from New York Law School. He also studied for two years at the University of Heidelberg, Germany, and speaks fluent German. He is a lifelong resident of Staten Island and is married to New York State Supreme Court Justice Judith McMahon. They have two children—Joseph, a senior at Notre Dame, and Julia, a freshman at Dartmouth.

STEPHEN BRODIE

PARTNER, HERRICK, FEINSTEIN LLP

Stephen Brodie has over 35 years of experience as both a corporate and a real estate lawyer. For most of that time, Steve represented financial institutions in commercial and private bank lending transactions, and in workout and restructuring matters. Steve is the Chair of Herrick's Financial Institutions Practice Group. His fine sense of leverage in business situations helps him anticipate the twists and turns of the most complex deals, and his strong negotiating skills enable him to bring those deals to fruition.

Steve represents commercial banks in secured and unsecured financings, including syndicated and single bank high-end middle market transactions; construction lending; IDA financings; mezzanine real estate financings; leasehold mortgage lending; asset-based lending; and in workouts and restructuring arising from such corporate and commercial loans, often involving complex intercreditor relationships. His practice is bolstered by his knowledge of New York's Lien Law and Real Property Law, and Article 9

(STEPHEN BRODIE CONT.)

of the Uniform Commercial Code, as well as his experience helping bank clients navigate through the complex business and documentation structures involved in New Markets Tax Credits transactions.

Steve's practice continues to expand, representing new business groups within his bank clients. He counsels private banking groups in lending against new kinds of collateral, such as fine art owned by both collectors and dealers, restricted stock and equity interests in closely held companies, and interests in professional sports teams. He also advises banks on creating and revising written credit policies for both art and real estate lending, and works closely with Herrick's Art Law Group in consignment and buy/sell transactions unrelated to bank financings.

Additionally, Steve has represented owners, developers, and co-op and condominium sponsors in construction, building conversions, commercial leasing and buy/sell transactions, as well as foreign lenders in financings for U.S. borrowers secured by real estate, oil tankers, oil refineries, ski resorts and other collateral.

Steve frequently contributes to Herrick's Lending and Restructuring Alert and to Herrick's Art and Advocacy newsletter. Steve also moderates and speaks at seminars on such topics as problem real estate and commercial loans, bank lending against art collateral, and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

IRWIN LATNER

PARTNER, HERRICK, FEINSTEIN LLP

Irwin Latner has a broad based practice that focuses on representing hedge fund and private equity fund managers in the establishment of private investment funds and their ongoing operations. Irwin represents both domestic and offshore managers who employ varied investment strategies and need assistance with fund set up and structuring, SEC registration and reporting, agreements with strategic investors, developing effective compliance programs, marketing and advertising practices, employment and compensation arrangements, portfolio investment transactions, derivatives, and compliance with the myriad of federal securities and commodities laws applicable to their business. In addition to representing investment advisers and fund managers, Irwin represents U.S. and non-U.S. based broker dealers, placement agents, commodity trading advisers, seeding firms, family offices and other types of financial service companies and alternative investment firms.

Irwin regularly speaks at hedge fund industry seminars and is frequently quoted in the press on current hedge fund industry issues. Irwin graduated magna cum laude from Brooklyn Law School.

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KEYNOTE SPEECH

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KEYNOTE SPEAKER

THE HONORABLE MICHAEL E. McMAHON

FORMER U.S. CONGRESSMAN
COUNSEL TO HERRICK, FEINSTEIN LLP

THE DODD-FRANK ACT: THE ONE YEAR RETROSPECTIVE

In 2008, America experienced the most devastating financial crisis since the Great Depression. The economy lost hundreds of thousands of jobs per month, credit froze, markets lost liquidity, some of the world's largest financial firms collapsed and we all saw unprecedented loss for investors and families. In just the last three months of 2008, $5 trillion of household wealth disappeared.

In the wake of such catastrophes, it was clear that America's financial regulatory system had to take a different route. Debate raged then and still rages on as to what direction that route should take. In response, Congress and the President attempted to lay out a roadmap, which we all now know as the Dodd-Frank Act. Did Congress and the President overreach? Or was a massive 2300-page overhaul necessary? And where has the road chosen by Dodd-Frank taken us, given all the detours since encountered, and where will we go? We hope to highlight and answer some of these questions today.

Representative Barney Frank, the co-author of the Dodd-Frank Act, described the Act as the best law ever created "to protect consumers and investors from abuses." The drafters and proponents of Dodd-Frank hoped to address major gaps and flaws in the regulatory landscape, to promote the financial stability of the United States, to end "too big to fail," to protect the American taxpayer by ending bailouts, to increase investment and entrepreneurship and to foster competitiveness, confidence in our financial sector and, most importantly, robust growth in our economy.

They envisioned a stronger and more resilient financial regulatory system, one that allows regulators to monitor and address threats to financial stability by improving accountability and transparency and one that has the ability to absorb shocks without disrupting financial markets. However, many of us in Washington at the time, myself included, maintained that achieving these goals should not be done without keeping American financial institutions and markets competitive in the era of increasing globalization. We sought to strike a balance. On the other hand, opponents of the Dodd-Frank Act believed, as Congressman Jeb Hensarling said, that "under this bill it is simply inevitable that the big will get bigger, the small will get smaller, the taxpayer will get poorer, and the economy will become more political."

Today, the question is what did we get? In the fourteen months since the passage of this sweeping overhaul of the nation's financial regulatory system we have seen rules enacted, studies conducted and new agencies created. Among other things, the Dodd-Frank Act created the Consumer Financial Protection Bureau to concentrate authority and accountability for consumer protection in one single federal agency; the Financial Stability Oversight Council to coordinate across agencies in monitoring risks and emerging threats to financial stability; and the Office of Financial Research to improve data quality and facilitate access to data.

However stated, there have also been numerous detours, many missed deadlines, and still a lot left to do. For instance, of the 87 studies required by the Dodd-Frank Act, only 24 have been completed as of June 2011, and of the 93 rules that the SEC is required to make, almost half are neither proposed nor finalized. The economy's continued sluggishness, with the elevated unemployment rate and constrained credit conditions, have also further intensified concerns about the Dodd-Frank Act and its ability to foster growth in our economy.

Among the major concerns of lawmakers and bankers are the unparalleled powers and the limited congressional oversight of the Consumer Financial Protection Bureau. America already experienced months of uncertainty when critics vowed to block Senate confirmation of Elizabeth Warren, the chief architect of this consumer agency, unless significant changes were made. Then, only three days prior to the launch of the consumer agency, President Obama nominated the former Ohio Attorney General Richard Cordray to lead the consumer agency. Still, the Consumer Financial Protection Bureau cannot impose new regulations until a director is actually confirmed and many Senators have vowed to block Mr. Cordray's confirmation.

The Financial Stability Oversight Council, which was charged with identifying risks to the financial stability of the United States due to material distress or failure of large interconnected financial firms, has yet to finalize the criteria that it will apply to determine whether certain financial institutions are systemically important. Furthermore, the membership of the FSOC has not been finalized as the new voting insurance member, former Treasury Official and Kentucky Insurance Commissioner S. Roy Woodall, who was nominated to the FSOC in July, still needs to be confirmed by the Senate.

Numerous rules, including those that govern the trading and processing of derivatives, have yet to be completed and current timelines will push the implementation process well into 2012. Moreover, the agency rules implementing the Volcker Rule, which is aimed at eliminating proprietary trading by banks, have yet to be proposed and the impact of the Volcker restrictions on U.S. competitiveness remains uncertain.

Furthermore, bankers are concerned about whether tightened standards in this country will put them at a disadvantage as they try to expand overseas.

In the meantime, two dozen bills in Congress seek to dismantle parts of the Dodd-Frank Act. While Senate Republicans refuse to consider nominations for posts at financial regulatory agencies, House Republicans have slashed budgets of financial market regulators – the SEC and the CFTC specifically – in an attempt to slow the implementation of the Dodd-Frank Act. Not only has sensible regulatory reform hit some detours, but it appears to be stuck in traffic gridlock.

As the final product is still unfinished, we at Herrick Feinstein provide you with this Symposium today to examine aspects of the Dodd-Frank Act, A Year One Retrospective. Our hope is to provide an improved guide to that still emerging road map. Our distinguished panel of financial and legal experts will assess the current regulatory initiatives to implement the mandates of the Dodd-Frank Act and discuss issues relating to bank stability, securitized financing and investment advisors. As critical as this discussion is to the financial services community, it is even more important to the greater American and world economies.

Welcome from all of us at Herrick. We look forward to a great exchange of ideas!

MICHAEL E. MCMAHON

HERRICK, FEINSTEIN LLP'S
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SCORECARD MOVING FORWARD:

STATUS OF ACTIVITIES REQUIRED UNDER THE DODD-FRANK ACT IN THE NEXT SEVERAL MONTHS BY THE THREE MAJOR REGULATORY AGENCIES

MICHAEL E. MCMAHON & LILIANA CHANG
HERRICK, FEINSTEIN LLP

SCORECARD MOVING FORWARD:

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Michael E. McMahon and Liliana Chang
Herrick, Feinstein LLP

Board of Governors of the Federal Reserve System

According to Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, in his testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs on July 21, 2011, the FRB is expected to, among other things, adopt and/or finalize the following rules:

- To define when a nonbank company is predominantly engaged in financial activities
- To define the terms “significant nonbank financial company” and “significant bank holding company”
- Jointly with the FDIC, to require large, systematically significant bank holding companies and nonbank financial companies to submit annual resolution plans and quarterly credit exposure reports
- To require reporting forms for savings and loan holding companies
- Jointly with other federal agencies, to establish margin and capital requirements for swap dealers, major swap participants, security based swap dealers and major security swap participants
- To permit entities under the FRB’s jurisdiction to engage in retail foreign exchange futures and options
- To supervise financial market utilities
- Jointly with other federal agencies, to implement the credit risk retention requirements applicable in connection with the issuance of asset backed securities
- Jointly with other federal agencies, to prohibit incentive based compensation arrangements that encourage inappropriate risk-taking by covered financial companies and to require the disclosure and reporting of certain incentive-based compensation information by covered financial companies
- Relating to nonbank companies that own at least one registered broker or dealer, and that are required by a foreign regulator or provision of foreign law to be subject to comprehensive consolidation provision
- Relating to alternatives to the use of credit ratings in the risk-based capital rules for banking organizations

Securities and Exchange Commission

The SEC provides a list of upcoming activities to implement the Dodd-Frank Act on its website.[1] In the next few months, the SEC is expected to adopt and/or finalize rules relating to:

- Prohibition of material conflicts of interests between certain parties involved in asset-backed securities and investors in the transaction
- Disclosure of pay-for-performance, pay ratios, and hedging by employees and directors
- Recovery of executive compensation
- Registration and regulation of security-based swap dealers and major security-based swap participants
- Prohibition on proprietary trading and certain relationships with hedge funds and private equity funds
- Risk retention by securitizers of asset-backed securities, and implementing the exemption of qualified residential mortgages from this prohibition
- Standards for clearing agencies designated as systemically important
- Process to be used by designated clearing agencies to provide notice of proposed changes
- Disclosure by institutional investment managers of votes on executive compensation
- Disclosure related to "conflict minerals", mine safety information and resource extraction issuers
- Trade reporting, data elements, and real-time public reporting for security-based swaps
- Clearing agencies for security-based swaps
- Registration and regulation of security-based swap data repositories
- Mandatory clearing of security-based swaps
- End-user exception to mandatory clearing of security-based swaps
- "Accredited investor" standard
- Disqualification of the offer or sale of securities in certain exempt offerings by certain felons and others similarly situated
- Due diligence for the delivery of dividends, interest and other valuable property to missing securities holders
- Registration of municipal advisors
- Threshold for "qualified client"
- Exchange listing standards regarding compensation committee independence and factors affecting compensation adviser independence; adopt disclosure rules regarding compensation consultant conflicts

[1] http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#08-12-11

In addition, the SEC is expected to report to Congress:

- Actions to implement the regulatory and administrative recommendations contained in the independent consultant's report on the SEC's organization
- Standardization within certain elements of the credit rating process
- Study of the costs and benefits of real time reporting on short sale positions

Commodity Futures Trading Commission

According to Gary Gensler, Chairman of the CFTC, in his testimony before the U.S. Senate Committee on Banking, Housing and Urban Affairs on July 21, 2011, the CFTC has substantially completed the proposal phase of rule-writing and is now working toward finalizing the rules. The CFTC provides on its website[2] areas in which rules are necessary to regulate the swaps marketplace including regulation of swap dealers and major swap participants, clearing, trading, data recordkeeping and reporting requirements and position limits, among other items.

In the next several months, the CFTC, jointly with the SEC, is expected to:

- Adopt rules to define key terms used in the Dodd-Frank Act with respect to derivative products and intermediaries
- Report to Congress a joint study regarding stable value contracts
- Adopt rules for dual-registered investment advisers, to implement reporting obligations on investment advisers related to the assessment of systemic risk

In addition, the CFTC plans to hold public meetings to continue to consider finalizing rules and to request additional public comments on the requirements related to swap transactions.

On September 8, 2011, Chairman Gensler announced, in fact, that the CFTC would further delay the new rules for the $600 trillion derivatives market. He indicated that the agency would conclude its rule-writing in the first few months of 2012 rather than by the end of the year as previously indicated. So far the agency has finalized 12 new rules. At least 40 additional rules remain on hold, including the most contentious proposals that will spell out which companies would be exempt from the mandates.

[2] http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/index.htm

CALENDAR OF IMPORTANT DODD-FRANK DATES

October 2011

October 1

- Debit card interchange rate, set by the FRB, is effective.

October 4

- Comments are due on a rule that transfers and re-designates authorities from the OTS to the FDIC.
- The CFTC will hold a rulemaking meeting.

October 11

- Comments are due on the FRB's proposed data collection changes for agricultural swaps.
- Comments are due on the OCC's interim final rule implementing the integration of OTS's authorities.
- Comments are due on the FRB's standards for retail foreign exchange transactions.
- Comments are due on a proposal that establishes procedures for securities holding companies to elect to be supervised by the FRB.

October 14

- The FDIC will hold a voluntary training about deposit insurance for bank employees.

October 18

- The CFTC will hold a rulemaking meeting.

October 19

- The OTS is abolished.
- Section 18(c) of the Federal Home Loan Bank Act is repealed.
- Section 21A of the Federal Home Loan Bank Act is repealed.

October 24

- The whistleblower rule is effective.

October 27

- Comments are due to the FRB's interim final rule that establishes regulations for savings and loan holding companies that it assumed from the OTS.

October 31

- CFTC final rule on registration requirements, statutory duties, core principles and certain compliance obligations for registered swap data repositories is effective.

November 2011

November 1

- Comments are due on the FRB's exemption and delay of uniform reporting for savings and loan and bank holding companies.
- The CFTC will hold a rulemaking meeting.

November 14

- The FDIC will hold a voluntary training about deposit insurance for bank employees.

November 16

- Comments are due on a farm credit administration proposal seeking to enhance investment oversight and to remove references to credit ratings from existing rules.

November 17

- The CFTC will hold a rulemaking meeting.

December 2011

December 7

- The FDIC will hold a voluntary training about deposit insurance for bank employees.

December 31

- Temporary relief from certain provisions of the Commodity Exchange Act for some swaps expires the earlier of December 31 or the effective date of the final rules amending the CEA.
- The CFTC final rule allowing agriculture swaps to transact subject to the same rules as other swaps is effective.
- 4Q 2010 will be the last quarter that agencies will accept the TFR data collection process. The Call Report will be uniformly required for the reporting period due March 31, 2011.

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THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S SLOW START AND THE DEBATE OVER BANK CAPITAL

BY STEPHEN BRODIE AND REGINA LIANG
HERRICK, FEINSTEIN LLP

THE FSOC'S SLOW START AND THE DEBATE OVER BANK CAPITAL

By Stephen Brodie

One of the more notable (and least controversial) changes brought about by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or the "Act") was the establishment of the Financial Stability Oversight Council (the "FSOC" or the "Council"). The Act states that the FSOC's purposes are (i) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (ii) to promote market discipline, by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the US government will shield them from losses in the event of failure; and (iii) to respond to emerging threats to the stability of the US financial system.

The FSOC consists of 10 voting members and five non-voting members. The 10 voting members are (i) the Secretary of the Treasury, who serves as the Chairperson of the Council; (ii) the Chairman of the Board of Governors of the Federal Reserve System; (iii) the Comptroller of the Currency; (iv) the Director of the new Bureau of Consumer Financial Protection; (v) the Chairman of the Securities Exchange Commission; (vi) the Chairperson of the Federal Deposit Insurance Corporation; (vii) the Chairperson of the Commodity Futures Trading Commission; (viii) the Director of the Federal Housing Finance Agency; (ix) the Chairman of the National Credit Union Administration Board; and (x) an insurance expert appointed by the President of the United States and confirmed by the Senate for a six-year term. The five non-voting members, who serve in an advisory capacity, are: (i) the Director of the Office of Financial Research ("OFR"); (ii) the Director of the Federal Insurance Office; (iii) a state insurance commissioner designated by the state insurance commissioners; (iv) a state banking supervisor designated by the state banking supervisors; and (v) a state securities commissioner (or officer performing similar functions) designated by the state securities commissioners.

Thus, the idea behind the FSOC is that the country needs a governmental organ with a high-level, 360 degree view, charged with identifying and helping to manage systemic risk. Section 112(a)(2)(N) of Dodd-Frank requires the FSOC to produce an annual report (the "Report") to discuss (i) the activities of the Council; (ii) significant market developments; (iii) emerging threats; (iv) the Council's determinations; and (v) the Council's recommendations. The FSOC issued the first such report on July 26, 2011, which made note of declining real estate prices, a sudden increase in term premiums on US government debt, and the escalation of the European sovereign debt crisis, as potential threats to the stability of the US economy. The Report recommends that market participants employ heightened risk management and supervisory attention in specific areas, such as (i) improving capital levels and liquidity risk profiles, and so called "living wills" that would facilitate resolution under bankruptcy without government assistance; (ii) bolstering resilience to unexpected interest rate shifts; (iii) maintaining discipline in credit underwriting standards; (iv) employing appropriate due diligence for emerging financial products; and (v) keeping pace with competitive, technological, and regulatory market structure developments. The Report recommends further reforms to address structural vulnerabilities in key markets, steps to address reform of the housing finance market, and coordination on financial regulatory reform. It asserts that three years after the financial crisis, our financial system is on more solid ground, specifically noting that financial institutions are now holding substantially more capital relative to risk.

Dodd-Frank grants the FSOC authority to determine that a nonbank financial firm's material financial distress could pose a threat to US financial stability, and subject such firm to enhanced prudential supervision by the Federal Reserve. The Council considers various factors in making this designation (in addition to the size of the entity in question), including leverage; off-balance-sheet exposures; and the nature, scope, size, concentration, interconnectedness, and mix of the various activities of the entity in question. The hope is that by closing gaps in regulation which existed prior to the crisis, when individual agencies narrowly focused on specific markets and often failed to monitor financial stability across multiple markets, the risk of a nonbank financial firm threatening the stability of the financial system will be materially reduced. Further, the FSOC has a statutory duty to facilitate information sharing and coordination among member agencies regarding policy development, rulemaking, examinations, reporting requirements, and enforcement actions for the domestic financial services industry. In instances where the data available proves insufficient, the FSOC has the authority to direct the newly created OFR to collect information from certain individual financial companies, to aid in the assessment of risks to the financial system.

Other than the Report, the FSOC has said and done little of any particular note during its first year of existence. Over time, of course, the work of the FSOC may prove to be far more interesting and important than anything it has done or said to date. The issue of bank capital (which the FSOC has commented upon, generally) is however, a very hot subject, right now. Long before the passage of Dodd-Frank, minimum capital requirements for banks were a point of great interest and some controversy. In 1988, the first so-called Basel Accord was held in Basel, Switzerland. This effort by the world's central bankers produced Basel I, a set of minimal guidelines of capital requirements for banks. In 1992, Basel I was given the force of law by the Group of Ten (the "G-10") countries. The G-10 consisted of 11 member countries: Belgium, Canada, France, Italy, Japan, the Netherlands, the United Kingdom, the United States, Germany, Sweden and Switzerland. In June 2004, at the second Basel Accord, the Basel Committee on Banking Supervision ("BCBS") published Basel II, which provided guidelines for banking regulators to guard against financial and operational risks, while maintaining sufficient consistency to protect against competitive inequality among institutions active in international banking business. Basel II rested on three pillars: (i) minimum capital requirements; (ii) supervisory review; and (iii) market discipline. The United States issued a final rule for the implementation of Basel II on December 7, 2007 and the final rule became effective April 1, 2008.

Arguably, Basel II was too little, too late. Despite the Basel Accords many believe that a major cause of the 2008 financial crisis was the failure of banks to hold sufficient capital. Thus, on December 16, 2010, the BCBS agreed upon Basel III, a new and heightened global regulatory standard for bank capital adequacy and liquidity. Basel III aims to improve the banking sector's ability to absorb shocks arising from financial and economic stress, to improve risk management and governance, and to strengthen bank transparency and disclosures.

Basel III will require that banks have: (i) a minimum common equity capital ratio of 4.5%; (ii) a minimum Tier 1 capital ratio of 6%; and (iii) a minimum total capital ratio of 8%. Common equity, which consists of common stock, retained earnings, and additional paid-in capital, is the equity that banks have available to absorb losses. Tier 1 capital consists of core capital, which includes equity capital (including instruments that cannot be redeemed at the option of the holder) and disclosed reserves or retained earnings. Simply put, Tier 1 capital includes common equity, preferred shares, and deferred tax assets. Tier 1 capital ratio refers to the ratio of a bank's core equity capital to its total risk-weighted assets (i.e., the total of all assets held by the bank weighted by credit risk according to a standardized formula). National regulators have varying ways of calculating bank capital, designed to meet the requirements within their national legal (and, arguably, political) framework.

Individual countries may, of course, impose capital requirements that are more stringent than Basel III. In late 2010, after the Swiss government had bailed out UBS AG ("UBS") by investing six billion Swiss francs to help UBS spin off $39 billion in assets into a Swiss bank fund, the government convened a panel to discuss regulatory reforms. The result was that UBS and Credit Suisse Group AG, Switzerland's "too-big-to-fail" banks, are now required to maintain a 19% total capital (equity and convertible bonds) ratio.

Bank of England Governor, Mervyn King, agrees with the Swiss that Basel III does not go far enough. King stated that Basel III's proposal to increase banks' capital buffers "on its own will not prevent another crisis" and "only very much higher levels of capital – levels that would be seen by the industry as wildly excessive most of the time – would prevent such a crisis." King argues that reforms must go further and perhaps require capital levels many times higher than those set by Basel III. Among other things, he has proposed (i) requiring banks to have more contingent capital (debt that converts into equity when an institution finds itself in trouble); (ii) splitting up banks and separating their more conventional components and investments from their higher risk operations; and (iii) forcing banks to match each investment made with funding over an equivalent time period. Many commentators initially saw King's proposals and comments, such as "the damaging externalities created by excessive maturity transformation and risk-taking must be internalized," as forewarning of the position the Bank of England would eventually take with respect to financial regulation. However, it is becoming increasingly clear that no drastic, Swiss-style, changes will be implemented until the UK's economy improves.

The controversy concerning bank capital made its way into the news this summer, in the anxiety surrounding the sovereign debt issue. The Committee of European Banking Supervisors (the "CEBS") completed the annual European Union-wide banking stress test exercise in July. The tests were conducted with hurdles more stringent than those of Basel II. Eight of the 90 banks failed the tests by falling below a 5% Tier 1 capital ratio requirement. The worst performer was Greece's ATE, whose Tier 1 capital ratio tested at negative 0.8%. (Basel II has a 4% Tier 1 capital requirement and Basel III will eventually have a 6% Tier 1 capital requirement.) The test results also showed that as many as 16 more banks would need to bolster capital, to comply with Basel III.

On the other hand, it is worth noting that if the tests had been performed at the end of 2010, as many as 20 banks would have failed. The intervening months allowed the banks to raise an additional 50 billion euros of capital. The tests triggered a clash between the EU regulatory officials and their national counterparts, over what is to be counted as "capital." Both German and Spanish regulators said their banks have sufficient capital, and German lenders criticized the "political" stress tests for using a Basel III benchmark not scheduled to be implemented for eight years, by excluding a form of non-voting bank capital known as "silent participations," recognized by local regulators, which do not reject losses as long as a bank is still in business. More noted in the press was the criticism concerning the 25% write-down on Greek government bonds, when the market had already driven down the price of 10-year Greek debt to 52% of the original value. Additionally, the EU regulators did not take into account in the tests the possibility of a sovereign default, even though the market, as seen through the pricing of credit-default swaps, believed there to be an approximately 87% chance that Greece would not be able to repay its debts. Similarly, the tests also included only a 22.3% writedown on Portuguese 10-year securities, when they were actually trading at 54% of their original value.

On September 9, 2011, Floyd Norris of the New York Times noted a parallel controversy over international accounting standards. Specifically, the head of the International Accounting Standard Board believes that certain banks in France, and in other EU countries have not been properly accounting for the value of the Greek government bonds they own.

In certain respects, Dodd-Frank is more rigorous than Basel III. Section 171 of the Act, the Collins Amendment, requires US banking regulators to impose the risk weightings applicable to small banks on the largest banks, as well. With the Collins Amendment, the Act phases out the risk-capital charge benefits that the larger US banks, adhering to Basel II, were supposed to have available. Further, there are limits as to what constitute Tier 1 capital, for large US bank holding companies that become effective between 2013 and 2016, far ahead of Basel III's parallel provisions.

Another major difference involves credit rating agencies. Basel III relies heavily on credit rating agencies' published ratings of certain securities in determining risk weighting and, therefore, the corresponding amount of capital that banks must hold against those assets. Section 939A of Dodd-Frank, however, precludes the use of credit ratings in the calculation of debt and securitization positions. The US regulatory agencies are in the process of developing an alternative to credit ratings, which may complicate the implementation of new capital standards.

Additionally, Section 331 of the Act, the FDIC's proposed deposit assessment rules, imposes an implicit additional capital charge upon big banks by determining assessments on the basis of assets less tangible equity capital, rather than simply the amount of deposits. FDIC Chairwoman Sheila Bair stated that she expects large US banks to have higher capital requirements than set forth in Basel III, and Federal Reserve Governor Daniel Tarullo suggested that the biggest banks should hold as much as 14% of assets in capital.

In addition to regulators, journalists, academics and the US banks themselves, have all weighed in on this debate. New York Times columnist Joe Nocera and Stanford Professor Anat Admati have pointed to the demise of Merrill Lynch, AIG, and certain big banks, and blame such collapses primarily on inadequate capital. This school of thought holds that (i) requiring a capital cushion would allow banks to absorb losses, instead of taxpayers (and that low capital requirements merely allow banks to take more risk and make more money -- until they crash and need a bailout); (ii) Basel III does not go far enough, and the implementation of the Basel III requirements being delayed until 2019, raises other issues; and (iii) many European banks simply cannot presently afford to meet more demanding capital requirements, and the relatively low hurdles and long delay in implementation are designed to mask the true weakness of the banks. This side insists that the United States can and should have more stringent capital requirements, regardless of what other countries (other than Switzerland) do. The idea is that the United States would be trading bank profits for a safer financial system.

On the other side of the debate, former Chairman of the Federal Reserve Alan Greenspan and JPMorgan Chase CEO Jamie Dimon argue that the Act's limitations on bank activities reduce the need for additional capital requirements and other similar non-capital measures, because banks will no longer be able to take on the kinds of risk that led to the crisis of 2008. They point, for example, to the Volcker Rule that will prohibit banks from engaging in proprietary trading, or sponsoring or investing in private equity funds or hedge funds. Similarly, the Lincoln Amendment, Section 716 of the Act, will force banking institutions to transfer much of their swap related activities to nonbank affiliates. This school also believes that if the weak European banks are enjoying the benefits of Basel III's relatively relaxed standard or if Basel III is to be watered-down elsewhere in the world, as some industry executives and lobbyists are pushing to do, competitive pressure warrants the same for US banks. Dimon believes, for example, that US regulation of over-the-counter derivatives could prove too expensive for investors and drive swaps business overseas. T. Timothy Ryan Jr., president and chief executive of the Securities Industry and Financial Markets Association, warns US regulators against "creating unnecessary barriers to market entry and putting US financial markets and economies and individuals who rely on their depth and liquidity at a disadvantage."

At Herrick, we have actually run across foreign bankers intent upon expanding their business in the United States, specifically because they believe that Dodd-Frank has hamstrung the US banks and created competitive opportunities for other banks. The politics of the situation are, of course, intriguing. 2012 is an election year and the large financial institutions will surely use their money and influence to advance their interests; but the populist anger over TARP and "bailouts for billionaires" can still be felt -- to a point where politicians cannot afford to ignore it. The unfortunate reality seems to be that bank capital is a very complex subject, about which reasonable people can fairly differ; and the current political process has little or no capacity to intelligently resolve controversies that cannot be understood through dueling sound-bites.

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THE TRUTH ABOUT BANK CAPITAL

BY ROBERT TEITELMAN
THE DEAL LLC

THE TRUTH ABOUT BANK CAPITAL

By Robert Teitelman, The Deal LLC

Joe Nocera in The New York Times has decided he's in favor of more bank capital. In his column, he makes this seem like his personal endorsement is necessary to push across the line what he calls "the most important reform moment since the financial crisis broke out three years ago. More important even than the wrangling over Dodd-Frank." Well, this falls within the pundit's right to hyperbole, as the headline on the column, "Banking's Moment of Truth," falls within the bounds of the headline writer's exaggeration exemption -- though the more I look at it, the more that "truth" bothers me. Personally, turning to the most important person in the world -- moi -- I would, if forced to take a stand, vote for higher capital standards for the big banks, though the question is not nearly as clear and straightforward as Nocera makes out. There's not a lot of "truth," or a lot of empirical economic evidence arrayed against any of this. There's intuition, gut feel, a sense that something must be done and lots of credentialed and noncredentialed opinions.

Both Dodd-Frank and the bank capital standards are classic economically driven arguments that will be judged by future performance and consequences that, unfortunately, we have no way to predict. It's like voting for a president. Nocera gets the basic argument essentially right. Generally, the more equity you amass, the less debt you can take on. That will tend to dampen leverage and, as we know, leverage was one of those evils at the center of the crisis. Nocera's blithe confidence that if Merrill Lynch & Co. and AIG had had "adequate capital requirements" those two firms would not have been bailed out is a stretch, given the shadow banking system that grew up and the obvious failures of oversight. How does he explain Bear Stearns Cos. and Lehman Brothers? How do you factor in the degree of sheer panic as opposed to inadequate capital that threatened all firms?

Nocera is correct that a larger equity capital cushion does provide a way for banks, rather than taxpayers, to absorb more losses. But there are no guarantees. Banks have been collapsing for centuries. Even the Swiss, which have already mandated capital of 19% (both in equity and so-called contingent convertible bonds), well above anything Basel III envisions, know that banks stuffed with capital can collapse. Indeed, the most obvious sign of trouble is the belief that your capital is adequate to withstand stupidity and disaster. Historically, there seems to be a positive relation between stupidity and excess capital (although, to be fair, thin capital may be evidence of recklessness as well).

Nocera stacks the deck a bit. He wheels out "bank expert" and one of DealBook's house pundits, Simon Johnson, with Stanford's Anat Admati, both of whom he insists have "demolished" the arguments "put forth by the big banks and their Congressional spokesmen against higher capital requirements." Indeed, Johnson, who has actively promoted Admati as the voice of wisdom on this subject for months, does offer up a clear outline of the position for higher capital requirements on his blog, The Baseline Scenario. But as with nearly everything Johnson touches, the nuances drain away and everything goes to black and white. Besides, turning back the arguments of lobbyists and politicians on a subject as arcane as this is sort of like debating particle physics with a Hollywood star on "Bill Maher."

What are the reservations here? They begin with the question lobbed at Ben Bernanke by J.P. Morgan Chase & Co.'s Jamie Dimon on what economists know of the relation of bank capital to jobs. Bernanke admitted that not much is known; in other words we're guessing. Johnson argues that the job issue is a false one with capital -- that lending is not related to the amount of equity you're required to pile up. That's right, technically. But we also know that higher levels of equity will tend to depress returns on equity over time, all things being equal. Lower ROEs might well be something to applaud; one of the better arguments for how we got into this mess was that both managers and shareholders of the big banks began to feel that a 15% ROE was a reasonable, if ambitious-bordering-on-reckless, benchmark to aim for. Shareholders came to expect that -- or at least an effort to reach it -- and rising executive pay hung on the share prices that resulted. The big banks were thus pitted against public investment banks and every other company in the market, probably to their detriment and ours. An unhealthy race to the bottom began.

More equity would make those targets infinitely more difficult to hit. Banks would look a lot stodgier. Again, this might be just what the doctor ordered, but it's not hard to see the unintended consequences. Bank executives would search for businesses that could get more horsepower, and that inevitably means taking on more risk, thus making more demands on regulation, which will inevitably fail at some point, the likelihood rising with time and success.

And what about those jobs? Perhaps lending would not be affected by the increase in equity capital. But what, these days, do we define as lending? Do we mean credit cards, mortgages, corporate loans, securitizations, structured finance? Do we mean big loans to strategic M&A deals, private equity buyouts or prime brokerage? How far into the middle market will this lending extend?

The unfortunate reality is that we've evolved an economy that feeds off a finance sector, including the big banks, that is, highly liquid, highly differentiated (by product) and highly speculative. It's easy to say from MIT, as Johnson does regularly, that we need to immediately shatter this "addictive" finance-heavy system (he was a major proponent of breaking up the banks); that's Bill Maher talk. And it's easy to say in the long run we'll be better off -- though we have no idea what the long run will hold. But any "reform" we make at the big banks will inevitably have immediate consequences throughout an extremely complex and highly evolved real economy (really a nervous, psychologically sensitive and slightly wacked-out political economy), which already suffers from serious structural woes and lackluster growth. So it's not just the anxiety that fewer loans will be made; it's a sense that for all of our technical expertise, we have no real consensus what the drivers of this economy -- or some "better" and future economy -- really are. We only have economic pundits, from this camp and that, offering views and back-of-the-envelope calculations.

That's why I hesitate, not that I have a vote. All that said, the kind of surcharges and capital increases being discussed for Basel III and attributed in the U.S. to the Federal Reserve's Daniel Tarullo, seem reasonable, even sensible. But these increases -- even at the nosebleed levels of the Swiss -- resemble earthwork levees thrown up in the face of a flood more than hardened bulwarks against bailouts. They are hardly guarantees. And they will spawn consequences we have not anticipated.

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THE DEAL ECONOMY BLOG: TRANSACTIONS

BY ROBERT TEITELMAN
THE DEAL LLC

THE DEAL ECONOMY BLOG: TRANSACTIONS
April 25, 2011

By Robert Teitelman, The Deal LLC

What is a bank? We used to know. In days of yore, banks were easily defined and recognized as banks: columns, marble, vaults, tellers with toasters, brown-suited bankers with putters. Wells Fargo and Bank of America were banks; **Goldman, Sachs & Co.** and **Morgan Stanley** were not. The latter gold-dust twins were investment banks, wholesale banks, white-shoe banks, merchant banks, broker-dealers, and thus sequestered by legislation from the unwashed proletariat. Of course, that was before the world grew fatter, faster, richer, more global, more networked, more performance oriented and, in America, more unequal. Commercial and investment banking converged into a fermenting mass called Banking. And when nearly everything became a bank, when nearly every money product found a home in a bank, the once sharp outline of Banking blurred until it merged with the activity known as Finance. Today that's just one part of our problem. Big banks are too big, too complicated, too incestuous. Their capacity to change, grow and evade regulation resembles an alien life form. Their appetite for risk is gargantuan. They are scary marvels. Can't live with 'em, can't live without 'em.

The debate over big banks occurs under different guises. The political rump wrings its hands over Wall Street, its philistines, plutocrats, greedheads, oligarchic powers and pay packages. This debate is mostly conducted through insults; its underlying drive is envy; its subtext inequality. From the regulatory camp, the argument, like those that swirl around nuclear safety, orbits the word containment. This debate produces volleys of jargon; its underlying fuel is fear; its subtext, growth. The Brits recently published a report on what to do about the banks from a group led by former Bank of England chief economist Sir John Vickers. Some expected them to propose radical surgery; instead they put out a deceptively comfortable-shoe report that ring-fences retail banks and refreshingly acknowledges minor tradeoffs like growth versus safety. The report has triggered agita, probably a good sign.

Still, even Vickers may underestimate the tangled nest of big-bank incentives. Banks operate in multiple dimensions rife with every-which-way incentives. Paradox often trumps alignment. Martin Jacomb, former chairman of the U.K.'s **Prudential plc**, fingers one such paradox when he argued in the Financial Times that the more onerous the rules to limit risk, the likelier managers will indulge in it. Rigid rules may shift responsibility from managers to regulators, who, given the complexity of everything, inevitably play catch-up. You can take that further: Too many rules mean no single rule counts for much. Moreover, banks suffer from serving two masters: regulators and shareholders. (Often enough, given their lobbying clout, there's a third lurking: Congress. And a fourth, bankers themselves.) We expect interests of multiple masters to be hammered into alignment; in reality, they're often at odds. And the salient fact of banking evolution since the '70s is that ownership, particularly on Wall Street, has grown more public, and that institutional shareholders, dragging large portfolios, have developed a hunger for risk.

Skepticism should prevail about any incentive "rule" that derives from economists' penchant for distilling behavior from utility functions. The psychology is fodder for witch doctors. In real life, management behavior, hostage to personality, culture, history or sunspots, eludes prediction. The fact that banks have been collapsing since Pericles suggests there's no structural panacea. Despite nostalgia for restoring partnerships (safe! small!), their record is spotty as a Dalmatian. Consider the **Baring** Brothers partnership in London, which triggered the Panic of 1890 and had to be rescued, only to succumb in 1995. While unlimited liability partnerships might restrain size and risk taking, they also stifle liquidity and growth. And to extoll partnerships, with their direct link between ownership and management, is to acknowledge the flaws of shareholder governance. Moreover, we're ambivalent whether it's better to offer more "product" to investors by broadening public ownership or whether we favor risk control and inequality through private ownership. As for rigid oversight of banks as a solution -- well, again, what's a bank anyhow? Barriers between commercial and investment banks first gave way in the '80s when regulated banks lost business to loosely regulated nonbanks. Partial regulation encourages disintermediation, which spawns either overreaching reregulation or under reaching deregulation. The real problem is that we expect banks to be all things -- efficient, smart, safe, stimulative, public, pals of the proletariat, tools of foreign policy, purveyors of toasters -- and all things financial to be banks. Our expectations overwhelm our good sense.

For more commentary from Robert Teitelman, please, see The Deal Economy blog at www.thedeal.com/thedealeconomy.

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ASSET-BACKED SECURITIZATION AND CREDIT RATING AGENCIES

BY PATRICK D. SWEENEY & JULIE ALBINSKY
HERRICK, FEINSTEIN LLP

ASSET-BACKED SECURITIZATION AND CREDIT RATING AGENCIES

By Patrick D. Sweeney and Julie Albinsky

I. Summary of Dodd-Frank Provisions and Resulting Regulations 29

A. Improvements to the Asset-Backed Securitization Process 29
(i) Requirements for Credit Retention in ABS Transactions 29
(ii) Increased Disclosure and Reporting by ABS Issuers 35
(iii) Representations and Warranties for ABS Transactions 37
(iv) Reporting Regarding Repurchase Activity 38
(v) Due Diligence Review in ABS Offerings 39
(vi) Conflicts of Interest Relating to ABS 40

B. Improvements to Regulation of Credit Rating Agencies 40
(i) Internal Controls 40
(ii) Preventing Conflicts of Interest 42
(iii) SEC Oversight 43
(iv) Transparency 43
(v) Liability and Changes to Statutory Regime Governing NRSROs 43
(vi) Removal of Exemption of NRSROs From Liability as "Experts" 45
(v) Reduced Reliance on Credit Ratings 46

II. Changes in the Market 49
A. Asset-Backed Securitization Process 49
B. Regulation of Credit Rating Agencies 53

III. Concluding Remarks 55

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was enacted on July 21, 2010 with the goals of stabilizing the financial markets and preventing a recurrence of the recent market turmoil. Since the asset-backed securities ("ABS") market and credit rating agencies have both been the subject of much criticism, and have been singled out as significant causes of the financial crisis, Dodd-Frank seeks expansive regulatory reform in both areas. More than a year after its enactment, however, we still, to a large extent, do not know exactly what regulatory changes will result from Dodd-Frank or what the impact of those changes will be on the financial markets. This is because, like many other parts of Dodd-Frank, the provisions dealing with ABS and credit rating agencies did not enact changes but rather tasked regulatory agencies with promulgating rules and regulations. We have yet to see the full impact on the markets of the final rules promulgated under Dodd-Frank.

I. SUMMARY OF DODD-FRANK PROVISIONS AND RESULTING REGULATIONS

A. Improvements to the Asset-Backed Securitization Process

The intent of the Dodd-Frank provisions dealing with ABS transactions is to enhance transparency and disclosure, and to reduce certain risks associated with ABS transactions. The changes that Dodd-Frank contemplated include: (i) credit retention requirements (the so-called "skin in the game" requirements), (ii) increased disclosure and reporting requirements for ABS issuers, (iii) enhanced representation and warranties in securitization documents and (iv) enhanced due diligence and disclosure requirements with respect to loans underlying securitization transactions. The substantive provisions of regulations implementing these changes were largely left to the Securities Exchange Commission ("SEC"), the Office of the Comptroller of the Currency ("OCC"), the Board of Governors of the Federal Reserve System (the "Board") and the Federal Deposit Insurance Corporation ("FDIC").

(i) Requirement for Credit Retention in ABS Transactions

Summary of Dodd-Frank provisions:

After the financial crisis, legislators realized that ABS transactions were structured in a way that caused the economic interests of securitizers and investors to be at odds. In ABS transactions, the originator of a loan (e.g., a lender who makes the initial extension of credit) did not ultimately bear the risk of the loan's repayment, and in fact had financial incentives to maximize the number of loans originated without regard to ultimate repayment since the originator's fees are based on the number of loans originated. Some lenders used an "originate-to-distribute" business model with loosened underwriting standards, knowing that the loans could be sold through a securitization and they would retain little or no continuing exposure to the quality of those assets.

Under Dodd-Frank, the SEC, jointly with federal banking agencies, was tasked with prescribing regulations to require "securitizers" (defined as either (a) an issuer of an ABS or (b) a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuer) or "originators" (defined as a person who (a) through the extension of credit or otherwise, creates a financial asset that collateralizes an ABS and (b) sells an asset directly or indirectly to a securitizer) to retain at least 5% of credit risk in the aggregate, or less if certain underwriting standards are met, of any financial assets transferred, sold or conveyed through the issuance of ABS. Securitizers and originators must be prohibited from hedging or otherwise transferring the credit risk required to be retained. Dodd-Frank broadly defines ABS as a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, lease, mortgage, or secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset. Dodd-Frank cited various examples of ABS, including collateralized mortgage obligations (CMO), collateralized debt obligations (CDO), collateralized bond obligations (CBO), CDO of an ABS, CDO of a CDO, and any other security determined by the SEC.

The aim of this so-called "skin in the game" requirement is to incentivize the person involved in a securitization to create a higher quality financial product to ensure a higher likelihood of repayment, thereby aligning the interests of the securitizer with the interests of the investors. The obligation of risk retention is initially imposed by Dodd-Frank on securitizers; however, the regulators are tasked with determining the appropriate allocation of the risk retention obligation between a securitizer and originator if the securitizer purchases assets from an originator.

The form and duration of any credit risk retention requirements were left up to the regulators. Separate rules were contemplated for different types of asset classes (e.g., commercial mortgages, residential mortgages, auto loans, commercial loans), as the SEC and federal banking agencies deemed appropriate.

A number of specific exemptions from the credit retention requirement are included in Dodd-Frank, and regulators were given discretion to create additional exemptions, so long as such exemptions ensure that securitizers and originators use high-quality underwriting standards, encourage appropriate risk management practices and improve access to business and consumer credit on reasonable terms, or are otherwise in the public interest and would protect investors.

Summary of Proposed Rules:

On March 29, 2011, the SEC, OCC, Federal Reserve Board, FDIC, Federal Housing Financing Agency and the Department of Housing and Urban Development released proposed rules to implement the credit risk retention requirements contemplated by Dodd-Frank.[3] The comments period, which had been extended to August 1, 2011, is closed as of the date of this article. However, final regulations will likely be a long time in coming since the proposed rules posed many questions and the volume of comments has been high.

As contemplated by Dodd-Frank, the proposed rules would require sponsors (the definition of "sponsor" is substantially identical to the second definition of securitizer (a person who organizes and initiates an ABS transaction by selling or transferring assets, either directly or

[3] "Credit Risk Retention", SEC Release No. 34-64148 (March 29, 2011), available at: http://www.sec.gov/rules/proposed/2011/34-64148.pdf

indirectly, including through an affiliate, to the issuer)) to retain not less than 5% of the credit risk of any asset that the sponsor transfers, sells or conveys to a third party through the issuance of an ABS, and would prohibit a sponsor or any of its consolidated affiliates from hedging or otherwise transferring the risk. The proposed rules account for the diversity of securitized assets by providing several options for meeting the risk retention requirement. Also as contemplated by Dodd-Frank, the proposed rules provide for exemptions to the risk retention requirement for qualified residential mortgages ("QRMs"), and various other types of assets (including qualifying commercial real estate ("CRE") loans, commercial loans and automobile loans) that meet established underwriting standards. The proposed rules also contain a controversial "premium capture cash reserve account" requirement that was not part of Dodd-Frank, which is designed to prevent sponsors from structuring ABS to effectively negate or reduce their retained economic risk. The regulators' stated goal is to structure the risk retention requirements in a flexible manner that would not negatively affect the availability and costs of credit to consumers and businesses.

The proposed rules would require sponsors of both publicly and privately offered ABS to retain an economic interest equal to 5% of the aggregate credit risk of the assets collateralizing an ABS, which risk may not be hedged or otherwise transferred (subject to certain exceptions). Dodd-Frank contemplated that this requirement would be imposed on securitizers, and the proposed rules clarify that a sponsor is a type of securitizer. If a securitization transaction has multiple sponsors, only one is required to comply with the risk retention requirements; however, each sponsor would remain responsible for ensuring that at least one sponsor complies. The regulators believe that imposing the requirement on sponsors is appropriate in light of the active and direct role they typically have in arranging the securitization transaction and selecting the assets to be securitized. This requirement would also apply in the aggregate to all ABS issued by an issuing entity (including issuers, such as master trusts, that issue ABS periodically). The proposed rules would permit, subject to certain conditions, a sponsor to reduce its required risk retention obligations by the portion of risk assumed by an originator(s) that has/have originated at least 20% of the asset pool.

Various forms of risk retention have developed in the securitization market due to the diversity of securitized assets and the structures commonly used in securitizing different types of assets, as well as other considerations such as accounting implications for sponsors and other entities, investor preferences and credit rating agency requirements. The proposed rules would allow sponsors to choose from several forms of "base" risk retention, as follows:

- *Vertical retention*: retention of not less than 5% of each class of ABS interests issued in the securitization transaction. A sponsor choosing this option would be required to disclose to investors (and to regulators, upon request) the amount (expressed as a percentage and dollar amount) of each class of ABS retained and the amount required under the rules to be retained, as well as the material assumptions and methodologies used to determine the amount retained.

- *Horizontal retention*: retention of a first-loss residual interest in an amount equal to at least 5% of the par value of all ABS interests issued in a securitization transaction. An interest would quality as "first loss" if it is an interest that is allocated all losses on the securitized assets until the par value of the class is reduced to zero and has the most subordinated claim to payments of both principal and interest. In lieu of holding a horizontal residual interest, a sponsor may establish and fund (in cash) a reserve account at closing in an amount equal to the amount required to be retained under the horizontal method. This account would be held by the trustee for the benefit of the issuer, and until all ABS interests are paid in full or the issuer is dissolved, the account would be used to satisfy payments on ABS interests on any payment date when the issuer has insufficient funds to satisfy the amounts due. A sponsor choosing the horizontal retention or the horizontal cash reserve account option would be subject to the same disclosure requirements as for the vertical method (with appropriate modifications for the reserve account option).

- *L-shaped retention*: equally divided combination of vertical and horizontal retention; a sponsor would retain a 2.5% vertical component and a 2.564% horizontal component (the amount is calibrated to avoid double counting the horizontal portion as part of the vertical component). A sponsor choosing the L-shaped retention option would be subject to the same disclosure requirements as for the vertical and horizontal options.

- *Representative sample*: retention of a representative sample of assets (chosen in accordance with an established process) designated for a securitization in an amount equal to at least 5% of the unpaid principal balance of all designated assets. A sponsor choosing the representative sample option would be subject to the same disclosure requirements as for the vertical option and in addition would be required to disclose its policies and procedures for choosing the representative sample of assets and a description of the material characteristics of the designated pool and the representative sample.

- *Additional option for commercial mortgage-backed securities*: retention of a horizontal interests by a third party purchaser (this option is only available if certain requirements are met).

Other risk retention options are also available for revolving asset master trusts and asset-backed commercial paper conduits.

In addition to the "base" risk requirement, if a sponsor structures a securitization to monetize excess spread on the underlying assets (e.g., through the sale of an interest only tranche or premium bond), the proposed rules would require the sponsor to deposit the premium or purchase price received on the sale of the tranches that monetize the excess spread into a "premium capture cash reserve account". The proposed rules also contain an anti-evasion provision to prevent a sponsor from circumventing the premium capture requirement by taking back at closing and then reselling additional ABS interests.

Prior to the financial crisis, in many securitization transactions (especially those involving residential and commercial mortgages) sponsors sold premium or interest-only tranches, and by so monetizing the excess spread sponsors were able to reduce the impact of any economic interest they may have retained in the outcome of the transaction and the credit quality of the assets they securitized. This created incentives to maximize the size and complexity of securitization transactions, and encouraged loose underwriting standards. The regulators designed the premium capture requirement, which was not contemplated by Dodd-Frank, to prevent sponsors from effectively negating or reducing the base risk they are required to retain. In addition, the premium capture requirement aims to simplify securitization structures (the proposed rules note that a likely consequence of this requirement will be that securitizations will not be structured to monetize excess spread at closing) and to better align the interests of sponsors and investors by preventing sponsors from receiving compensation in advance.

The amount of the required upfront premium deposit would depend on the "base" risk retention option the sponsor chooses. The upfront premium deposit must be the difference (if positive) between (i) the gross proceeds received by the issuer from the sale of the ABS interests in the issuing entity to persons other than the sponsor and (ii) (x) if the sponsor retains credit risk under the vertical, horizontal, L-shaped or additional option for master trusts, 95% of the par value of the ABS interests in the issuing entity issued as part of the securitization transaction and (y) if the sponsor retains credit risk under the representative or commercial mortgage-backed option, 100% of the par value of the ABS interests in the issuing entity issued as part of the securitization transaction. The premium capture cash reserve account would be held by the trustee for the benefit of the issuer, and, until all ABS interests are paid in full or the issuer is dissolved, amounts in the account would be used to satisfy payments on the ABS interests on any payment date when the issuer has insufficient funds to make such payments.

Certain categories of assets would be exempted from the risk retention requirements, including a blanket exemption for QRMs, and exemptions for qualifying CRE loans, commercial loans, and automobile loans that meet stringent underwriting criteria and are therefore considered conservative enough that no risk retention is required. The proposed rules would impose disclosure requirements designed to allow regulatory agencies to monitor compliance with these underwriting standards. The proposed rules also contain government-related exemptions, exemptions for certain re-securitized transactions, and exemptions for certain foreign-related transactions. The proposed rules also provide that the 100% guaranty of Fannie Mae or Freddie Mac will be deemed to satisfy the credit risk retention requirements, and that Fannie Mae or Freddie Mac are not themselves subject to the up-front premium requirements or the anti-hedging prohibition under such circumstances. This aspect of the proposed rules is fairly controversial, as it provides a funding cost advantage to sponsors of transactions guaranteed by Frannie Mae or Freddie Mac over sponsors of private-label real-estate mortgage backed securities, and some predict it would slow the recovery of private sector mortgage financing.

The definition of QRMs developed by the regulatory agencies is intended to create very high quality residential mortgage financial products with low risk even in turbulent economic environments. For an ABS to qualify for the QRM exemption, each asset in the pool would have to be currently performing at the time of closing of the securitization and the depositor must certify that it evaluated and confirmed the effectiveness of its internal supervisory controls for ensuring that all assets in the pool are QRMs as of a date within 60 days prior to the cut-off date for establishing the pool. If, after relying on the QRM exemption, it is determined that one or more mortgages in the pool does not meet QRM criteria, the sponsor must, within 90 days after such determination, repurchase each loan that does not qualify at a price at least equal to the remaining principal balance and accrued interest on such loan. The proposed eligibility criteria for QRMs include:

- a QRM must be a closed-end first-lien mortgage with a maturity of no greater than 30 years, used to purchase or refinance a one-to-four family property, at least one unit of which is the principal dwelling of the borrower;

- requirements regarding borrower credit history (not based on credit scores, but a set of "derogatory factors" such as being past due on debt obligations currently or within the past 2 years, being a debtor in a bankruptcy proceeding, or having property foreclosed on or repossessed);

- a QRM may be either fixed or adjustable rate mortgage, but may not provide for interest only payments, negative amortization, balloon payments or prepayment penalties; for adjustable rate mortgages, the increase in the annual rate of interest may not exceed 2% over any 12-month period or 6% over the life of the loan;

- loan-to-value ("LTV") ratio caps (for a purchase mortgage transaction the cap is 80%, for a term or rate refinancing loan the cap is 75% or 70% for cash-out refinancing);

- minimum borrower down-payment;

- each QRM must be supported by a written appraisal;

- the ratio of the borrower's mortgage payments to gross income may not be greater than 28%, and the ratio of the all of borrower's debt payments to gross income may not be greater than 36%;

- the total fees and points payable by the borrower may not exceed 3% of the total loan amount; and

- QRM documentation must contain default mitigation obligations for the lender.

In order to qualify for an exemption from the risk retention requirement, a CRE (defined by the proposed rules as a loan secured by a property with 5 or more single-family units, or by nonfarm non-residential real property the primary source (50% or more) of the repayment for which is expected to be derived from specified sources) must meet certain underwriting standards, including:

- the debt service coverage ("DSC") ratio must be 1.7 or greater, or 1.5 or greater for property that has a stable net operating income and where the loan meets certain other requirements;

- the loan must have a fixed stated interest rate; however, the proposed rules allow for an adjustable interest rate if the borrower obtains (prior to or simultaneously with the closing of the loan) a derivative product that effectively results in the borrower paying a fixed interest rate;

- the combined LTV must be less than or equal to 65%, or, if the capitalization rate used in the appraisal is less than the 10-year interest rate swap plus 300 basis points, 60%;

- the originator must conduct an analysis of the borrower's ability to service all of its outstanding debt, net of any income generated from the CRE, for the two years following the closing date of the loan;

- the originator must also determine whether the purchase price for the CRE property that secures the loan reflects the current market value of the property and whether the borrower has sufficient equity in the property to incentivize continued performance of loan obligations; and

- the CRE loan documents must contain certain covenants, including (i) reporting covenants designed to facilitate the ability of the originator to monitor and manage credit risk over the term of the loan, (ii) covenants restricting the borrower's ability to further encumber the CRE property, and (iii) covenants requiring the borrower to protect the value of and the originator's interest in the CRE property.

(ii) Increased Disclosure and Reporting by ABS Issuers

Summary of Dodd-Frank provisions:

Dodd-Frank directs the SEC to issue regulations imposing new disclosure requirements on issuers of publicly offered ABS with respect to asset-level information for each tranche or class of security issued, including loan-level data, if such data is necessary for investors to independently perform due diligence. The SEC was tasked with prescribing a standardized format for disclosing such data in order to facilitate due diligence by investors, including analysis and comparisons of data.

In addition, prior to the enactment of Dodd-Frank, certain categories of mortgage-backed securities were exempt from registration under the Securities Act of 1933, as amended ("Securities Act"); however, Dodd-Frank removed this exemption. Dodd-Frank also removed the ability of issuers of publicly offered ABS to suspend their reporting obligations under Section 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") (this would include reports on Form 10-K, 10-Q and 8-K) even if they have fewer than 300 security-holders. Generally, issuers of publicly offered ABS with an effective registration statement must file ongoing reports with the SEC. Prior to the enactment of Dodd-Frank, the Exchange Act automatically suspended the 15(d) reporting duties of issuers of publicly offered ABS if the securities of each class were held by less than 300 persons. Due to this provision of Dodd-Frank, issuers of publicly offered ABS will no longer have this exemption from reporting. This provision was effective immediately upon enactment of Dodd-Frank. However, the SEC was given authority to suspend or terminate this duty to file reports for any or all classes of ABS.

Summary of Proposed Rules:

On July 26, 2011, the SEC re-proposed rules regarding shelf registration eligibility requirements for ABS, and these rules include asset-level disclosure requirements.[4] The original proposed rules were issued by the SEC in April 2010, and in this re-proposal the SEC is seeking comments on whether this re-proposal satisfies the requirements of Dodd-Frank, whether there are privacy concerns related to disclosing certain borrower information and if additional information should be disclosed.

As contemplated by Dodd-Frank, the proposed rules would require issuers of ABS, at minimum, to disclose asset-level and loan-level data (if necessary for investors' due diligence), including: the terms of the assets; the characteristics of the obligors; the underwriting of the assets; for residential mortgages, data having unique identifiers relating to loan brokers and originators, and the name of originators of assets for all asset classes, including the MERS (Mortgage Electronic Registration Systems, Inc.); and number of originators of residential mortgages, if any. In order to facilitate comparisons of data across securities in similar types of assets, asset-level information must be presented in a standardized format, and must be included in the prospectus and periodic reports filed with the SEC in standard form and in a tagged data format using Extensible Markup Language. Dodd-Frank mandated the SEC to include in its regulations a requirement that issuers disclose asset-level information on the nature and extent of the compensation of the broker or originator of the asset backing the security; however, the proposed rules do not contain this requirement, although the SEC did request comments on whether this requirement should be enacted. The SEC stated in the proposed rules that this decision was based on their belief that the proposed disclosure requirements may provide the information necessary for investors to perform due diligence on the asset pool with respect to broker involvement because investors can analyze the method in which a loan was underwritten based on the disclosed data. The proposed rules would also require ABS issuers to disclose any interest the sponsor retained in the transaction, including the amount and nature of the interest; however, the proposed rules do not go as far as Dodd-Frank contemplated to require such disclosure on an asset-level.

Although Dodd-Frank did not mandate this, the SEC has proposed amendments to Rule 144A that would impose the same requirement for privately offered ABS (relying on an SEC safe harbor for sale of unregistered structured finance products to an investor (including an "accredited investor" under Regulation D of the Securities Act and re-sales to a "qualified institutional buyer" (QIB) under Rule 144A promulgated under the Securities Act) by requiring that, as a condition for resale, the underlying transaction agreements contain a covenant by the issuer to provide, upon request, to the security holder or prospective purchaser of securities substantially the same information as required to be reported in a registration statement. This information would be delivered at the time of the offering and updated on an ongoing basis.

On August 22, 2011, the SEC adopted final rules that will require most issuers of publicly offered ABS to continue to file periodic reports under Section 15(d) of the Exchange

[4] "Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities", SEC Release No. 33-9244 (August 5, 2011), available at http://sec.gov/rules/proposed/2011/3309244fr.pdf

Act for the life of the securities.[5] After the final rules become effective on September 22, 2011, issuers of publicly offered ABS will no longer have an exemption from reporting if the securities are held by less than 300 investors, and the duty to file periodic reports will only be suspended as to a class of ABS when no registered ABS of that class are held by non-affiliates of the ABS depositor. The duty to file will be re-evaluated semi-annually. In a no-action letter, the SEC has stated that it will not recommend enforcement action against any issuers of publicly offered ABS for not filing periodic reports if such issuer's duty to file was suspended prior to the enactment of Dodd-Frank.[6]

(iii) Representations and Warranties for ABS Transactions

Summary of Dodd-Frank provisions:

The SEC was directed by Dodd-Frank to enact regulations requiring each nationally recognized statistic rating organization ("NRSRO") to include in reports accompanying ratings of both publicly and privately offered ABS a description and comparison of the representations, warranties and enforcement mechanisms available to investors and how they differ from those of other securities.

Summary of Final Rules:

On January 21, 2011, the SEC issued final rules (the "Disclosure Rules") requiring NRSROs to include in their ratings reports, issued on or after September 26, 2011, information about the representations, warranties and enforcement mechanisms in securitization transactions as well as a comparison to those contained in similar transactions ("similar" in the NRSRO's judgment, based on its industry knowledge and experience with previous deals).[7] The representations, warranties and enforcement mechanisms to be disclosed include not only those with respect to the underlying assets, but all those contained in the securitization transaction documents. These requirements apply to both registered public offerings and private offerings of ABS, and "credit rating" includes any expected or preliminary rating and applies to unsolicited ratings by an NRSRO. An NRSRO may not satisfy these new requirements by incorporating the required disclosures by reference to the transaction's offering documents.

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[5] "Suspension of the Duty to File Reports for Classes of Asset-Backed Securities Under Section 15(d) of the Securities Exchange Act of 1934", SEC Release No. 33-65148 (August 22, 2011), available at: http://www.sec.gov/rules/final/2011/34-65148.pdf

[6] American Securitization Forum, SEC No-Action Letter (January 6, 2011), available at: http://www.sec.gov/divisions/corpfin/cf-noaction/2011/asf010611-15d.htm

[7] "Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection" SEC Release No. 33-9175 (January 26, 2011), available at http://www.sec.gov/rules/final/2011/33-9175fr.pdf

(iv) __Reporting Regarding Repurchase Activity__

<u>Summary of Dodd-Frank provisions</u>:

The SEC was tasked by Dodd-Frank with enacting regulations requiring securitizers to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by such securitizer, so that deficiencies in underwriting would be transparent to investors.

<u>Summary of Final Rule</u>:

The Disclosure Rules impose new and extensive reporting and disclosure requirements on securitizers (the SEC clarified that this includes sponsors and depositors[8]) with respect to past and future repurchase or replacement activity arising from breaches of representations and warranties made in securitization transactions.

On or before February 14, 2012, each securitizer who, during the three-year period ending December 31, 2011, organized or initiated either publicly or privately offered ABS transactions (either directly or indirectly, including through an affiliate) that contain a covenant to repurchase or replace assets in the event of a breach of a representation or warranty and are held by non-affiliate third parties, must file an initial report on Form ABS-15G disclosing all fulfilled and unfulfilled requests for asset repurchases or replacements (regardless to merit of any such request) based on breach of representation or warranty for its entire portfolio of securitized assets for the three-year period ending December 31, 2011. Securitizers may omit information that is unknown or not reasonably available without unreasonable effort or expense. Disclosure must be made in a prescribed tabular format with narrative explanations where necessary, and the information to be provided includes: asset class; name of originator; number, principal balance and percentage of assets (i) subject to demand for repurchase or replacement (whether or not in dispute), (ii) repurchased or replaced or pending repurchase or replacement, (iii) subject to a withdrawal of a repurchase or replacement request, and (iv) subject to a rejected repurchase or replacement request. The SEC has clarified that if two or more affiliated securitizers participate in a single ABS transaction, only one must file the initial report.

Thereafter, a securitizer is also required to file quarterly reports for any calendar quarter during which it had outstanding ABS that are held by non-affiliate third parties and contain repurchase/replacement covenants. The quarterly report must disclose repurchase and replacement activity during such calendar quarter. If no such activity occurred, the securitizer may check the appropriate box and thereafter will only be required to file a quarterly report for a quarter during which such activity occurs.

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[8] For purposes of the new final rules, the depositor for ABS acting solely its capacity as depositor to the issuing entity is the "issuer' for purposes of the ABS of that issuing entity. "Depositor" means the depositor who receives or purchases and transfers or sells the pool assets to the issuing entity. For ABS transactions where there is not an intermediate transfer of the assets from the sponsor to the issuing entity, the term depositor refers to the sponsor. For ABS transactions where the person transferring or selling the pool assets is itself a trust, the depositor of the issuing entity is the depositor of that trust.

Prospectuses with regard to registered public offerings of ABS that occur on or after February 14, 2012 where the underlying documents contain a repurchase/replacement covenant must also disclose three years of repurchase and replacement data. However, prospectuses filed prior to February 14, 2013 may contain only one year of prior data, and prospectuses filed after February 14, 2013 but prior to February 14, 2014 may contain only two years of prior data. The prospectus must also reference the securitizer's most recent Form ABS-15G. In addition, with regard to registered public offerings of ABS, any periodic report filed on Form 10-D[9] after December 31, 2011 must contain repurchase and replacement disclosure and must reference the securitizer's most recent Form ABS-15G.

The reporting requirements contained in the Disclosure Rules also apply to foreign issuances if the securitizer is subject to the jurisdiction of the SEC. Dodd-Frank expanded the scope of the SEC's jurisdiction with respect to investigations and enforcement actions; however, whether the SEC has jurisdiction over a particular person or entity is a highly fact-specific determination and decided on a case-by-case basis.

(v) ***Due Diligence Review in ABS Offerings***

Summary of Dodd-Frank provisions:

The SEC was also tasked by Dodd-Frank with issuing regulations requiring issuers of registered ABS to perform a review of the assets underlying the ABS and to disclose the nature of this review in the registration statement.

Summary of Final Rules:

On January 20, 2011, the SEC issued final rules requiring issuers (which include both sponsors and depositors[10]) of publicly registered ABS with respect to all bona fide offers commencing after December 31, 2011 to conduct a due diligence review of the pool of assets underlying such ABS, and to report the nature and findings of the review in the prospectus.[11] At minimum, the review must be designed and effected to provide reasonable assurance that the disclosure regarding the underlying assets in the offering documents is accurate in all material respects. This standard is designed to be similar to the standard many public companies use in designing and maintaining disclosure controls and procedures required by the Exchange Act. The nature of the review can vary depending on various factors, including the type and number of assets as well as the type of securitization vehicle used. The SEC envisions the review requirement as a flexible, principles-based standard that would be workable across a wide variety of asset classes and issuers.

The review may be conducted by the issuer or by one or more third parties. The issuer may either obtain the third party's consent to be named as an "expert" in the registration

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[9] A Form 10-D is filed by ABS issuers to report interest, dividend and capital distributions.
[10] See footnote 6.
[11] "Issuer Review of Assets in Offerings of Asset-Backed Securities", SEC Release No. 33-9176 (January 25, 2011), available at http://www.sec.gov/rules/final/2011/33-9176fr.pdf

statement and attribute the findings and conclusions to the third party, or disclose that the review was conducted by a third party but attribute the findings and conclusions to itself.

The prospectus must disclose findings and conclusions, as well as the nature and scope, of the review (including whether a third party performed the review). Information that must be disclosed includes: the process governing which assets were evaluated; how the evaluated assets measured up to review criteria; and data on the amount and characteristics of assets that did not measure up to criteria.

(vi) Conflicts of Interests Relating to ABS

Dodd-Frank amended the Securities Act to prohibit any underwriter, placement agent, initial purchaser or sponsor (or any of their respective affiliates or subsidiaries) of an ABS, during the year after the first closing of the sale of the ABS, from engaging in any transaction that would involve or result in any material conflict of interest with respect to any investor in a transaction arising out of such activity. This would prevent, for example, an arranger of an ABS transaction from also assuming a short position on those ABS. The SEC was directed to issue implementing regulations; however, although the deadline set by Dodd-Frank has passed, no implementing regulations have yet been enacted.

B. Improvements to Regulation of Credit Rating Agencies

Dodd-Frank expresses Congressional findings that the inaccuracy of credit ratings of structured finance products contributed significantly to the mismanagement of risks by financial institutions and investors, and adversely impacted the health of the U.S. economy. Credit rating agencies play a critical "gatekeeper" role in the debt market that is functionally similar to that of securities analysts and auditors, and so Dodd-Frank seeks to improve the overall quality and integrity of credit ratings by implementing internal and external control structures, increasing potential liability, and promoting a more transparent credit rating process.

(i) Internal Controls

Summary of Dodd-Frank provisions:

Dodd-Frank requires that NRSROs implement and maintain an internal control structure, and that an annual report be submitted to the SEC describing the role of management in establishing and maintaining effective internal controls, assessing the effectiveness of such internal controls and containing an attestation by the CEO of the NRSRO.

The SEC was tasked with prescribing rules to set procedures and methodologies (including qualitative and quantitative data and models) to be used by NRSROs in determining credit ratings. Rules must include a requirement that NRSROs consider information about an issuer other than information received from the issuer or underwriter if such information is credible and potentially significant. The procedures and methodologies used by the NRSRO must be approved by its board and any material changes to such procedures and methodologies must be applied consistently to all ratings; the reason for the change must be publicly disclosed; and all users must be notified of such change as well as any significant errors identified.

Each NRSRO must designate a compliance officer who does not perform a credit rating function and whose compensation is not linked to the NRSRO's financial performance. The compliance officer must submit annual reports to the SEC describing the NRSRO's compliance with securities laws and its own internal policies and procedures.

Each NRSRO must also have a board of directors with at least half but no fewer than two members who are independent (that is, who do not accept fees from the NRSRO, except for service as a director, who are not associated with the NRSRO or any affiliated company, and who are not involved in determining ratings in which the NRSRO has a financial interest). The functions of the board must include establishing, maintaining and enforcing policies and procedures for determining credit ratings and addressing conflicts of interest, and evaluating and maintaining effectiveness of internal controls.

Dodd-Frank also requires the SEC to enact rules to ensure that persons employed by NRSROs meet standards for training, experience, and competence necessary to produce accurate ratings and that such persons are tested for knowledge of the credit rating process.

Summary of Proposed Rules:

On May 18, 2011, the SEC proposed rules (the "NRSRO Proposed Rules") to implement some of the Dodd-Frank provisions aimed at improving the regulation of credit rating agencies. [12] The comments period for these proposed rules ended on August 8, 2011. Under the NRSRO Proposed Rules, NRSROs would be required to file an annual internal controls report with the SEC containing a description of the responsibility of management in establishing and maintaining an effective internal control structure, and an assessment by management of the effectiveness of the NRSRO's internal control structure. Together with this annual report must be filed an annual report of the NRSRO's designated compliance officer.

The SEC has proposed to defer prescribing factors for NRSROs to consider in implementing an internal control structure. Dodd-Frank's requirement that NRSROs must establish, maintain, enforce and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings, is self executing and so the SEC has proposed to first observe (through examination and annual reporting) how NRSROs achieve compliance instead of prescribing factors from the outset.

The NRSRO Proposed Rules would require each NRSRO to establish and maintain standards for training, experience, and competence that are reasonably designed to ensure that its ratings employees produce accurate credit ratings. NRSROs will have some discretion in designing standards; however, the NRSRO Proposed Rules set forth various factors to consider. In addition the NRSRO Proposed Rules would require an NRSRO's standards to include

[12] Proposed Rules for "Nationally Recognized Statistical Rating Organizations", SEC Release No. 34-64514 (May 18, 2011), available at http://www.sec.gov/rules/proposed/2011/34-64514.pdf

specific testing and experience requirements, including periodic testing of employees who determine credit ratings on their knowledge of the NRSRO's procedures and methodologies, and a requirement that at least one individual with at least 3 years of credit analysis experience participate in each credit rating determination.

(ii) ***Preventing Conflicts of Interest***

Summary of Dodd-Frank provisions:

Dodd-Frank tasks the SEC with promulgating rules to prevent sales and marketing considerations from influencing credit ratings. If any former employee of an NRSRO is hired by an issuer, underwriter or sponsor of a security rated by the NRSRO, such NRSRO must be required to review its ratings for any such entity or securities in which such employee participated during the one year period prior to the rating action to determine whether any conflicts of interest existed. In addition, each NRSRO must report to the SEC the names of its former employees who, within the previous five years, became employees of any issuer, underwriter or sponsor of a security rated by the NRSRO, and who participated in the rating process during the one year period prior to such employment, and the SEC will make such information publicly available.

Summary of Proposed Rules:

The NRSRO Proposed Rules would prohibit an NRSRO from issuing or maintaining a credit rating where a person within the NRSRO who participates in the sales or marketing of a product of service of the NRSRO or a product of service of a person associated wit the NRSRO also participates in determining or monitoring the credit rating, or developing or approving the procedures or methodologies for determining the credit rating, including qualitative and quantitative models. The NRSRO Proposed Rules do not offer guidance on the definition of "sales and marketing", what it means to "participate" in sales and marketing or what it means to participate in developing or approving procedures and methodologies used for determining credit ratings; however, the SEC has requested comments on whether it should provide such guidance. An exemption from this new prohibition would be available to small NRSROs if, upon application, the SEC finds that such small NRSRO does not have the resources or staff to fully comply with this prohibition; however, the SEC will have the power to impose conditions designed to preserve as much of the separation between sales and marketing activities from rating activities as possible.

"Look-back review" requirements with respect to NRSRO employees are also proposed by the NRSRO Proposed Rules. As contemplated by Dodd-Frank, under the rules as proposed, an NRSRO would be required to establish and maintain policies and procedures regarding former employees who participated in any capacity in determining credit ratings and who were subsequently employed within 1 year by an entity subject to such credit rating, or by the issuer, underwriter or sponsor of a product subject to such rating. The NRSRO would be required to conduct a "look-back review" to determine whether any conflict of interest of the employee influenced the credit rating and if any such conflict of interest is detected, the NRSRO would at minimum be required to immediately place the credit rating on credit watch, promptly determine whether the credit rating must be revised (the SEC states in the NRSRO Proposed Rules that it does not expect a revision of a credit rating in every instance in which an earlier rating was influenced by a conflict of interest, rather the NRSRO should take action if appropriate) and promptly publish the revised credit rating or affirm the present rating if appropriate. In addition, if a conflict of interest is detected, the NRSRO will be required to immediately notify users of credit ratings and to publish an explanation of why a credit rating was revised or affirmed after a conflict of interest has been determined.

(iii) SEC Oversight

Dodd-Frank mandated that the SEC establish a new Office of Credit Ratings to administer the SEC's rules with respect to NRSROs and conduct annual examinations of NRSROs (the results of which would be publicly available), including examination of whether the agency is complying with its internal policies, procedures and methodologies, how it manages conflicts of interest, its processing of complaints, and its employment policies as well as monitoring of post-employment activities of its former staff. Due to budgetary reasons, the SEC has not yet fully staffed this new office, but has instead added personnel to existing offices to perform the function of examining NRSROs.[13]

(iv) Transparency

Summary of Dodd-Frank provisions:

Dodd-Frank requires that each NRSRO publicly disclose certain information and such disclosures must be comparable among NRSROs to allow investors to compare the performance of credit ratings issued by different NRSROs. The content of such disclosures must include: (i) performance of ratings, including historical performance of the rating, expected probability of default and expected loss in case of default; (ii) assumptions underlying credit ratings procedures and methodologies; (iii) data relied upon to determine credit rating and information regarding the reliability, accuracy and quality of the data; (iv) potential limitations of the credit ratings (including types of risk excluded from the rating), (v) conflicts of interest, and (vi) explanations of the measure of the potential volatility of the rating (including any factors that may lead to a change in the rating and the magnitude of any potential change).

In addition, such disclosures must be accompanied by an attestation that ratings were not influenced by other business activities of the NRSRO, were based solely on the merits of the rated instrument, and were the product of an independent evaluation of the risks and merits of an investment product.

Summary of Proposed Rules:

The NRSRO Proposed Rules would require each NRSRO to publicly disclose certain information in its initial credit ratings and any information relating to any subsequent change to such ratings. Specifically, NRSROs will be required to publish a form with each "rating action"

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[13] Jesse Eisinger and Jake Bernstein, "From Dodd-Frank to Dud: How Financial Reform May Be Going Wrong", June 3, 2011, available at: http://www.propublica.org/article/from-dodd-frank-to-dud/single

containing specified information about the rating, and if the rating action relates to an ABS, any certification relating to the rating provided to the NRSRO by a third party due diligence provider. The term "rating action" is defined broadly and includes the publication of an expected or preliminary rating, an initial rating, an upgrade, downgrade, affirmation or withdrawal of a rating, or the placement of an existing rating on credit watch or review. The format of the information presented must be easy and helpful for users of credit ratings, in a standardized form to facilitate direct comparisons across types of securities, and must be readily publicly available. The proposed rules largely mirror Dodd-Frank in specifying the extensive qualitative and quantitative information that must be disclosed in forms accompanying each credit action. The SEC has requested comment on the proposed disclosure requirements, including on whether certain of the requirements (e.g., disclosing certain assumptions underlying a rating) would require disclosure of proprietary information. In addition, each form accompanying a credit action must contain an attestation by the NRSRO that no other business activities influenced the rating, the rating is based solely on the merits of the instrument being rated, and the rating rests solely on an independent evaluation of the risks and merits of the instrument.

Currently, NRSROs are required to disclose performance measurement statistics with respect to each class of credit ratings for which it is registered, at minimum showing performance in each class over 1-year, 3-year and 10-year periods, including information regarding whose ratings change over time (the transition rate) and default rates within each rating category. The NRSRO Proposed Rules would standardize the methodology for calculating and presenting such information.

Currently, each NRSRO is required to disclose on its corporate website complete rating histories for all credit ratings initially determined by such NRSRO on or after June 26, 2007 (the so-called "100% Rule"), and the NRSRO Proposed Rules would expand the "100% Rule" to apply to all ratings that were outstanding as of June 26, 2007. The new "100% Rule" would require NRSROs to publicly disclose the rating history for free on an easily accessible portion of their corporate website, include an XBRL file (easily searchable format), and expand the amount of information disclosed. Under the new proposed rule, an NRSRO may stop disclosing a rating history no earlier than 20 years after the withdrawal of the credit rating.

The NRSRO Proposed Rules also implement the Dodd-Frank provisions regarding universal rating symbols. NRSROs would be required to have policies and procedures that are reasonably designed to access the probability that an issuer of a security or money market instrument will default, clearly define each symbol in the NRSRO's rating scale, and apply any such symbol in a consistent manner.

(v) ***Liability and Changes to Statutory Regime Governing NRSROs***

Summary of Dodd-Frank provisions:

Dodd-Frank subjects the statements of NRSROs to the same enforcement and penalty provisions of the Exchange Act as statements by registered public accounting firms or securities analysts, which means that a private right of action may be brought against an NRSRO. However, Dodd-Frank clarifies that statements made by NRSROs will not be deemed forwardlooking statements for purposes of the Exchange Act safe harbor, which means that statements made by NRSROs will not be subject to liability as projections of future performance. In an action for securities fraud by a private plaintiff against an NRSRO, the required "state of mind" is that the NRSRO knowingly or recklessly failed to conduct a reasonable investigation of the facts it relied upon or to obtain reasonable verification of the facts from other competent sources independent of the issuer and the underwriter.

The SEC is granted the power to suspend or revoke the registration of an NRSRO with respect to a class or subclass of securities if the SEC determines (after notice and hearing) that the NRSRO lacks adequate financial or managerial resources to consistently produce credit ratings with integrity. In addition, the SEC may impose sanctions on persons associated with an NRSRO for certain types of misconduct.

Disclosures made by issuers of securities to NRSROs will no longer be exempt from Regulation FD. Under Regulation FD, if an issuer discloses any material nonpublic information regarding itself or its securities to certain persons or entities, the issuer must also publicly disclose such information. Previously, disclosures to NRSROs were exempt from this requirement.

Summary of Proposed Rules:

Dodd-Frank provided that statements of NRSROs would be subject to the same enforcement and penalty provisions of the Exchange Act as statements by registered public accounting firms or securities analysis. The NRSRO Proposed Rules would implement this provision by designating certain submissions by an NRSRO to the SEC as "filings" rather than "furnishings". Filings, unlike furnishings, are subject to liability for damages for being false or misleading as to any material fact.

The NRSRO Proposed Rules provide that the SEC would be able to suspend or revoke an NRSRO's registration if it finds that: (i) the NRSRO has violated any rule under the Exchange Act (conflicts of interest rules), (ii) the violation affected the rating, and (iii) the suspension or revocation is necessary for the protection of investors and in the public interest. The NRSRO Proposed Rules would also empower the SEC to establish new fines, penalties and sanctions to be imposed on NRSROs for violations of the federal securities laws.

(vi) Removal of Exemption of NRSROs From Liability as "Experts"

Dodd-Frank repealed Rule 436(g) of the Securities Act which exempted NRSROs from liability as "experts" by virtue of the inclusion of their ratings in registration statements for ABS. In reaction, rating agencies refused to provide consents to have their ratings included in registration statements. The SEC responded to industry concerns that this would shut down public markets for ABS (since issuers are statutorily required to disclose in the prospectus any rating assigned to an ABS being offered publicly) by issuing a no-action letter allowing issuers to omit credit ratings from their registration statements. The exemption provided by the no-action letter was originally set to expire on January 24, 2011, but has been extended indefinitely. On July 21, 2011, a bill titled "The Asset-Backed Market Stabilization Act of 2011" was introduced in the House of Representatives, which would terminate the rule imposed by Dodd-Frank and reinstate Rule 436(g), shielding NRSROs once again from "expert" liability.

(vii) Reduced Reliance on Credit Ratings

Summary of Dodd-Frank provisions:

Dodd-Frank requires that statutory references to credit rating agencies and credit ratings be removed from federal statutes, and replaced with appropriate (in the regulators' discretion) credit-worthiness standards. This mandate will be difficult and time-consuming to put into practice, since credit ratings are interwoven through legislation governing many areas.

Summary of Proposed Rules:

On July 26, 2011, the SEC adopted final rules to remove credit ratings from the eligibility requirements to use short-form registration (on Form S-3 or F-3) for registering securities for public sale.[14] In order to be eligible to use short-form registration, an issuer must satisfy at least one "transaction requirement". Under the old rules, the transaction requirements included a requirement that the securities be non-convertible and have been rated by at least one NRSRO. The new rules establish four new alternative eligibility requirements to replace the "investment grade" category: (i) the issuer has (as of a date within 60 days prior to filing) at least $1 billion in non-convertible securities (other than common equity) in primary offerings for cash (not exchange), registered under the Securities Act within the previous 3 years; (ii) the issuer has (as of a date within 60 days prior to filing) at least $750 million of non-convertible securities (other than common equity) issued in primary offerings for cash (not exchange), registered under the Securities Act, currently outstanding (as opposed to option (i) which encompass the previous 3 years); (iii) the issuer is a wholly-owned subsidiary of a "well-known seasoned issuer" as defined under the Securities Act; or (iv) the issuer is a majority-owned operating partnership of a real estate investment trust (REIT) that qualifies as a "well known seasoned issuer". This change will likely decrease rating agencies' fees, as issuers turn away from ratings. However, some financial experts believe that investors will eventually come back to the rating agency model for evaluating their investments, and so the effect of these rules on credit agency fees may not be significant.[15]

In addition, the new rules revise and replace references in other rules and forms that relied on credit ratings, replacing such references with the new eligibility criteria. The forms and rules affected include: Form S-4 and F-4 (long-form registration forms under the Securities Act), Schedule 14A (for proxy statements under the Exchange Act), Rule 134 under the Securities Act (the new rules remove the safe harbor for disclosure of credit ratings in communications that would otherwise be deemed a "prospectus"), and Rules 138 and 139 under the Securities Act (publication or distributions of research reports by brokers or dealers about securities).

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[14] "Security Ratings", Release No. 33-9245 (July 26, 2011), available at http://www.sec.gov/rules/final/2011/33-9245.pdf

[15] Mark Ferraris, "Will New SEC Rule Pinch Rating Agency Fees?", February 10, 2011, available at: http://markferraris.wordpress.com/2011/02/10/will-new-sec-rule-pinch-rating-agency-fees/

The new rules will become effective on September 20, 2011; however, there is a grandfather provision allowing issuers who reasonably believe that they would have qualified to use Forms S-3 and F-3 under the old rules to utilize the "investment grade" transaction requirement until September 2, 2014. In the adopting release for the new rules, the SEC stated that they did not believe Congress intended to alter the pool of issuers eligible for short-form registration and access to shelf registration. Accordingly, the SEC envisions that substantially all issuers currently relying on the investment grade category will qualify under the new categories, and that the new rules will not result in fewer issuers being able to use short-form registration.

On March 2, 2011, the SEC proposed rules to remove references to credit ratings from various provisions of the Investment Company Act of 1940, most significantly eliminating credit ratings as a required element in determining whether a security is a permissible investment for a money market fund.[16] Money market funds are required under the Investment Act to invest at least 97% of their total assets in eligible securities that are "first tier securities" and no more than 3% of their total assets in eligible securities that are "second tier securities", and, in addition, the fund's board must also determine that at the time of purchase each security presents a minimal risk based on its credit quality. Currently, "first tier" means securities with the highest short-term rating, a comparable unrated security, securities issued by money market mutual funds or government securities, and "second tier" means securities with the second-highest short-term credit rating. Under the proposed rules, a "first tier" security would be one with respect to which the fund's board has determined that the issuer has the highest capacity to meet its short-term financial obligations, or any security issued by a money market mutual fund or by the government. A "second tier" security under the proposed rules would be one that the fund's board has determined presents minimal credit risk. The fund's board and advisers would be permitted to look at credit ratings in accessing the credit quality of a security, but they must also consult other sources, understand the method for determining the rating and make an independent judgment risk. The proposed rules would also impact the requirement that a fund reassess the credit risk of a security, which is currently tied to the downgrade of a credit rating. Instead, the fund would be required to reassess whether the security presents minimal credit risk if the adviser becomes aware of any credible information about a security in the fund's portfolio or any issuer of such a security that suggests the security is no longer a first tier or second tier security. In addition, the proposed rules modify the stress testing requirement (to test the fund's ability to maintain a stable net asset value) which is based on hypothetical events, currently including a downgrade in the credit rating of any portfolio securities. Under the proposed rules, the fund would be required to stress test for an adverse change in the ability of any issuer of a portfolio security to meet its short-term financial obligations.

In addition, the SEC has proposed a series of rules to remove various other references to credit ratings from its rules and regulations. First, under the proposed rules, reference to credit ratings would be removed from the exemption criteria under the anti-market manipulation rules, which prohibit issuers, selling security holders and distribution participants such as underwriters from purchasing securities that are the subject of a distribution while the distribution is underway. Second, the SEC has proposed to remove reference to credit ratings in the broker-dealer net capital rule. The net capital requirement is subject to various deductions ("haircuts"),

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[16] "References to Credit Ratings in Certain Investment Company Act Rules and Forms", SEC Release No. 33-9193 (March 2, 1011), available at: http://www.sec.gov/rules/proposed/2011/33-9193.pdf

one of which currently relies on credit ratings. The SEC proposes to remove references to credit ratings and replace the eligibility criteria for a "haircut" with a determination by the broker-dealer that the investment has a "minimal amount of credit risk" based on written policies and procedures designed to assess credit and liquidity risks (the SEC has proposed several factors such procedures should take into consideration). The SEC has also proposed to remove reference to credit ratings from broker-dealer reserve requirements and transaction confirmations. Third, references to credit ratings would be removed from definitions of "mortgage related security" and "small business related security" under the Exchange Act, which definitions afford favorable treatment under federal laws for extensions of credit.

On July 26, 2011, the SEC re-proposed rules regarding shelf eligibility requirements for ABS.[17] The original proposed rules were issued by the SEC in April 2010, and the re-proposal addresses Dodd-Frank's mandate to remove references to credit ratings. The re-proposed rules would replace the requirement that ABS offered off a shelf registration statement have an investment grade rating, with the following revised requirements: (i) a certification filed at the time of each shelf offering by the chief executive officer or executive officer in charge of securitization of the depositor regarding the disclosure contained in the prospectus and the design of the securitization; (ii) the underlying transaction documents must contain provisions (A) requiring repurchase request dispute resolution, (B) the appointment of a credit risk manager to review securitized assets upon the occurrence of certain trigger events and (C) mechanisms enabling investors to communicate with each other (by means of a request made on Form 10-D); and (iii) annual evaluation of compliance with the registration requirements for shelf eligibility.

The CFTC has also issued final rules on July 19, 2011 removing references to credit ratings from several of its regulations and substituting those references with alternative standards of creditworthiness, including regulations applicable to futures commissions merchants, derivatives clearing organizations, and commodity pool operators.[18]

II. CHANGES IN THE MARKET

A. <u>Asset-Backed Securitization Process</u>

The most significant regulations regarding ABS arising out of Dodd-Frank have not yet become effective, and so the story so far has been how industry insiders and investors are reacting to proposed rules and how the market has changed as a result of the crash. Legislators and the SEC have concluded that poorly designed collateralized debt obligations and other ABS contributed significantly to the collapse of the credit markets and the subsequent credit crisis. While regulators, with the assistance of comments from industry insiders, craft new rules and regulations to implement Dodd-Frank, structural changes have emerged in the ABS markets.

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[17] "Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities", SEC Release No. 33-9244 (August 5, 2011), available at http://sec.gov/rules/proposed/2011/3309244fr.pdf

[18] "Removing Any Reference to or Reliance on Credit Ratings in Commission Regulations; Proposing Alternatives to the Use of Credit Ratings", 76 FR 44262 (July 19, 2011), available at: http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2011-18777a.pdf

Much of the focus has been on commercial mortgage-backed securities ("CMBS"). After more than a two-year freeze, the CMBS market is cautiously coming back to life in an altered form, what industry insiders refer to as "CMBS 2.0". Through the first half of 2011, CMBS issuances totaled $17.1 billion,[19] while in 2010 the total for the entire year was approximately $12.7 billion.[20] Experts estimate that the total volume in 2011 could rise to between $30 billion and $40 billion.[21] Compared to the peak of the CMBS market in 2007 at $230 billion in issuances, this is a small and slow resurgence,[22] but industry experts are heartened by the upward trend and expect the CMBS market to continue rebounding.[23]

Investors and issuers remain cautious, as they are concerned about the potential impact of Dodd-Frank regulations (particularly about credit retention requirements) and the perceived erosion of the quality of underwriting standards.[24] Over the past year the press has documented increasing industry concern over the decline in underwriting standards from the previous year, which understandably harmed investor confidence. However, both Fitch and Moody's have released statements explaining that after the crash in 2008, underwriting standards became very stringent (much more conservative than standards used in 2003 and 2004, the pre-bubble years), but as the market began to revive, due to increasing investor confidence and demand for financial products, underwriting standards began to loosen back to normal, pre-bubble levels. [25] Fitch and Moody's further stated that the metrics currently used are substantially more conservative than those used in 2007 (the height of the bubble), but are understandably looser than the super conservative metrics employed immediately after the crash.[26] Recently, another blow was dealt to investor confidence when Standard & Poor's withdrew the rating it had given a $1.5 billion CMBS from Goldman Sachs Group Inc. and Citigroup Inc. the day before the transaction was set to close, forcing Goldman and Citigroup to pull the offering that was already placed with investors.[27] Standard & Poor's stated that the withdrawal was due to its discovery that two of its groups were using two different methods for calculating the debt service coverage ratios, which necessitates an internal review as to the impact on any outstanding ratings.[28]

Moreover, a more cautious, risk-averse approach is evolving due to lessons learned from the crash. CMBS were originated in the 1990's, and their structure had never been tested on a

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[19] Jeff Majewski, "Entering the Age of CMBS 2.0 With Optimism", July 20, 2011, available at: http://www.cpexecutive.com/newsletters/capitalmarkets-newsletter/investment-column/entering-the-age-of-cmbs-2-0-with-optimism/

[20] Adam Piore, "A behind-the-scenes look at how the commercial mortgage-backed securities market began rising from the dead," January 1, 2011, available at: http://therealdeal.com/newyork/articles/cmbs-2-0

[21] Jeff Majewski, "Entering the Age of CMBS 2.0 With Optimism", July 20, 2011, available at: http://www.cpexecutive.com/newsletters/capitalmarkets-newsletter/investment-column/entering-the-age-of-cmbs-2-0-with-optimism/

[22] Id.

[23] Adam Piore, "A behind-the-scenes look at how the commercial mortgage-backed securities market began rising from the dead," January 1, 2011, available at: http://therealdeal.com/newyork/articles/cmbs-2-0.

[24] "Is this the end of CMBS 2.0 or just a few careers on Wall Street?", July 29, 2011, available at: http://www.wealthstrategiesjournal.com/2011/07/is-this-the-end-of-cmbs-20-or.html

[25] Carrie Bay, "Fitch: is CMBS 2.0 a Sign of Healthy Growth or Cause for Concern?", July 25, 2011, available at: http://www.dsnews.com/articles/fitch-is-cmbs-20-sign-of-healthy-growth-or-cause-for-concern-2011-07-26.

[26] Id.

[27] "Is this the end of CMBS 2.0 or just a few careers on Wall Street?", July 29, 2011, available at: http://www.wealthstrategiesjournal.com/2011/07/is-this-the-end-of-cmbs-20-or.html

[28] Id.

large number of defaults until the recent downturn, which brought into stark relief the shortcomings of the CMBS 1.0 structures. The main differences between CMBS 1.0 and CMBS 2.0 structures include:

- The overall size of the transactions has decreased. Pre-bubble CMBS 1.0 aggregated pools in the range of $2 to $3 billion, while post-bubble CMBS 2.0 pools are much smaller. However, while the pools are smaller, the average individual loan size has doubled on average (from an average of $16 million to approximately $33.5 million), with smaller loans (under $10 million) rarely making an appearance at all.[29]

- The variety of assets in any given pool has decreased. CMBS 1.0 were comprised of at least 150 loans, while CMBS 2.0 are structured around an average of 50 assets, making due diligence review considerably easier.[30] In addition, lenders are asking for more detailed information about the borrower and properties, which also allows for greater due diligence.[31]

- Underwriting standards are more conservative, with lower loan-to-value ratios (LTV ratio) and higher debt service coverage ratios (DSC ratio).[32] Lower LTV ratios provide a greater buffer against declines in property values, while higher DSC ratios ensure that borrowers will be able to pay debt service on loans when due despite declines in property cash flows. In addition, some lenders are using a third ratio, a debt yield ratio (which is the net operating income of the property divided by the total loan amount) to better predict default risk, as this ratio measures the cash return a lender would obtain if it foreclosed on the property on the loan closing date.[33]

- Amortization of the underlying loans has become more common, as opposed to CMBS 1.0 which were often structured with loans that provided for interest only payments until maturity.[34]

- The average margin on individual loans has increased. In 2007, spreads were 100 basis points or lower, while in 2010 it was common to see spreads that were 300 basis points over the 10-year Treasury yield (resulting in a blended rate of approximately 6%), and in

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[29] Jeff Majewski, "Entering the Age of CMBS 2.0 With Optimism", July 20, 2011, available at: http://www.cpexecutive.com/newsletters/capitalmarkets-newsletter/investment-column/entering-the-age-of-cmbs-2-0-with-optimism/
[30] Id.
[31] Peter J. Mignone, "CMBS Lending Rebooted: Return to Basics", May/June AFIRE Newsletter, available at: http://www.snrdenton.com/pdf/AFIRE%202011%20May-June%20Newsletter.pdf
[32] Jeff Majewski, "Entering the Age of CMBS 2.0 With Optimism", July 20, 2011, available at: http://www.cpexecutive.com/newsletters/capitalmarkets-newsletter/investment-column/entering-the-age-of-cmbs-2-0-with-optimism/
[33] Peter J. Mignone, "CMBS Lending Rebooted: Return to Basics", May/June AFIRE Newsletter, available at: http://www.snrdenton.com/pdf/AFIRE%202011%20May-June%20Newsletter.pdf.
[34] Jeff Majewski, "Entering the Age of CMBS 2.0 With Optimism", July 20, 2011, available at: http://www.cpexecutive.com/newsletters/capitalmarkets-newsletter/investment-column/entering-the-age-of-cmbs-2-0-with-optimism/

2011 the spreads average around 250 basis points over the 10-year Treasury yield (resulting in blended rates of approximately 5.5 to 5.75).[35]

- Investor voting in the event of default has been altered. It became apparent from the battles for control during the bankruptcies of Extended Stay Inc. and Innkeepers USA Trust that the previous voting structure of allowing the controlling stakeholder to choose a special servicer did not account for conflicts of interest between majority and minority stakeholders.[36] CMBS are set up so that when borrowers default on a loan, the loan is turned over to a special servicer to direct the restructuring, including deciding whether to liquidate immediately.[37] The interests of majority and minority stakeholders are different in a default situation, as majority stakeholders with senior claims prefer to pull out quickly by liquidating because they are likely to be paid in full.[38] Accordingly, CMBS 2.0 are structured so that the decision to elect a special servicer is done through a majority vote of investors.[39]

- CMBS 2.0 lenders are more likely to require a bad-boy guarantor with significant creditworthiness, and scope of liability of such guarantors is being expanded beyond what was traditional in CMBS 1.0.[40]

- Lender-controlled cash management is becoming more common. Cash flows must go into a lender-controlled account, which allows the lender immediate access and control in a distress situation.[41]

- Another recent bankruptcy case, General Growth Properties, has revealed holes in the requirement that independent directors must approve a borrower's decision to file bankruptcy. CMBS 2.0 have begun to require that independent directors be provided by nationally-recognized companies, that the borrower provide advance notice before replacing any independent director, and that the borrower's governing documents require independent directors to consider (in deciding whether to file bankruptcy) only the interests of the borrower as an entity and its creditors, while only taking into account the interests of the equity owners to the extent of their economic interest in the properties.[42]

In addition to the structural changes in CMBS 2.0, the ABS industry will be significantly altered by Dodd-Frank regulations. The proposed credit risk retention rules (summarized above) specifically have raised much criticism from, and caused much anxiety to, industry insiders. One issue that has been raised is whether par value is an appropriate measure for retaining risk, since it would lead to retention of significantly different amounts of actual credit risk under the

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[35] Id.
[36] Kris Hudson, "Street Aims to Reboot CMBS," November 10, 2010, available at: http://online.wsj.com/article/SB10001424052748703585004575604790437414912.html
[37] Id.
[38] Id.
[39] Id.
[40] Peter J. Mignone, "CMBS Lending Rebooted: Return to Basics", May/June AFIRE Newsletter, available at: http://www.snrdenton.com/pdf/AFIRE%202011%20May-June%20Newsletter.pdf
[41] Id.
[42] Id.

"horizontal risk retention method" (retention of a first-loss residual interest in an amount equal to at least 5% of the par value of all ABS interests issued in a securitization transaction) than under the "vertical credit risk retention method" (retaining not less than 5% of each class of ABS interests issued in the securitization transaction). The proposed rules note that the horizontal method exposes a sponsor to the first 5% of all asset-pool losses and thus results in the sponsor retaining substantially more than 5% of the credit risk in a securitization.[43] Industry insiders have pointed out that this would impact collateralized loan obligations (CLO) negatively. A recent poll conducted by the Loan Syndication and Trading Association ("LSTA") showed that 87% of CLO managers polled lack sufficient capital and/or structure to be able to retain a vertical slice, and so the only feasible risk-retention option for CLOs would be horizontal retention.[44] A report issued by the LSTA states that the risk retention requirements would affect who could raise a CLO and would also significantly impact the volume of CLO generation.[45] The report further states that the recovery of the CLO market is important for U.S. non-investment grade companies to obtain sufficient growth capital in the next several years; if CLOs are unable to return to their historical role in the credit markets (helping to maintain liquidity in the markets and keeping down borrowing costs for corporate borrowers), debt service costs would increase for corporate borrowers.[46]

The 5% credit risk retention requirement has been criticized as too onerous, and a number of commentators on the proposed rules have urged the regulators to loosen eligibility criteria for qualified residential mortgages (which are exempt from the risk retention requirements), or alternatively lift the burden by modifying the proposed credit risk retention levels. The eligibility standards set for qualified residential mortgages, and other exemptions from risk retention requirements will undoubtedly re-shape and tighten the ABS market, as transactions will be structured in order to qualify for exemptions from the risk retention requirement.

The proposed risk retention rules do not define "par value", which is likely to create ambiguity unless regulators address this issue since industry custom and the intent that seems to be implied in the proposed rules are at odds. According to industry custom, par value means the stated amount of principal or liquidation preference of the securities; however, the text of the proposed rules implies that par value is intended to be the fair market value of the securities at the time of issuance.

Controversy has surrounded the proposed requirement that excess spread monetized by a sponsor at the closing of an ABS must be deposited into a premium capture cash reserve account, to serve as a first loss reserve for any losses on the collateral. Industry insiders have claimed this would make most existing ABS structures unworkable, which would be contrary to the

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[43] "Credit Risk Retention", SEC Release No. 34-64148 (March 29, 2011), available at: http://www.sec.gov/rules/proposed/2011/34-64148.pdf; "To the Point: Proposed Risk Retention Requirements for Sponsors of Asset-Backed Securities", Ernst & Young, April 21, 2010, available at: http://www.ey.com/global/assets.nsf/United%20Accounting/TothePoint_CC0320_ABSRiskRetention_21April2011/$file/TothePoint_CC0320_ABSRiskRetention_21April2011.pdf
[44] "The Impact of risk Retention on CLOs and Other Means of Aligning Incentives", Loan Syndication and Trading Association, available at: http://lsta.org/WorkArea/showcontent.aspx?id=11904
[45] Id.
[46] Id.

regulators' goals of reinvigorating lending and the securitization markets.[47] Legislators have expressed similar concerns; several members of the House submitted a letter to the regulators stating that the up-front premium deposit requirement was never contemplated by Dodd-Frank and urging the agencies to perform a rigorous cost-benefit analysis to determine the effect of the proposed requirement on economic growth and vitality of the securitization markets.

B. Regulation of Credit Rating Agencies

Most of the regulations with respect to credit rating agencies mandated by Dodd-Frank are still in the proposal stage; however, there have been very strong reactions to the NRSRO Proposed Rules that may very well shape the final regulations.

The credit agencies themselves have publicly expressed positive reactions to the NRSRO Proposed Rules.[48] Standard & Poor has stated that it "supports the SEC's efforts to increase accountability, transparency and oversight of credit rating firms while maintaining analytical independence", Moody's stated that it believes "regulatory change is healthy for the market" and that it is "committed to embracing that change", while Fitch issued a statement that the proposed rules "reflect constructive changes already in place at Fitch".[49]

The main criticism of the NRSRO Proposed Rules by financial experts and the press has been that they do not address the fundamental conflict of interest that arises from the "issuer pays" model, that is that rating agencies are paid by the issuers whose securities they are supposed to objectively rate.[50] In the final days of negotiations over Dodd-Frank, legislators chose to retain the "issuer pays" model, but proposed to mitigate conflicts of interest through various provisions, including those requiring separating analytical and marketing functions and "look back" reviews for employees.[51] The SEC will further consider, and has recently released a request for comments regarding,[52] whether to create an independent body that will randomly assign ratings engagements to different agencies (the so-called "Franken Proposal", named after Senator Al Franken from Minnesota who first proposed this approach during Dodd-Frank negotiations in May 2010).[53]

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[47] "Risk Retention Rule Gets No Industry Support", August 24, 2011, available at: http://www.appraisalinstitute.org/ano/DisplayArticle/Default.aspx?volume=12&numbr=15/16&id=15361; Wells Fargo comment letter regarding proposed credit risk retention rules, July 28, 2011, available at: http://www.sec.gov/comments/s7-14-11/s71411-177.pdf

[48] Kerri Panchuk, "Rating Agencies react favorably to SEC's proposed rules", May 18, 2011, available at: http://www.housingwire.com/2011/05/18/ratings-agencies-react-favorably-to-secs-proposed-rules

[49] Id.

[50] Ben Protess, "Rating Agencies Face Crackdown", May 18, 2011, available at: http://dealbook.nytimes.com/2011/05/18/rating-agencies-face-crackdown/; David S. Hilzenrath, "SEC Proposes New Rules for Credit-Rating Firms", May 18, 2011, available at: http://www.washingtonpost.com/business/economy/sec-proposes-new-rules-for-ratings-firms/2011/05/18/AFzPcY6G_story.html

[51] Ben Protess, "Rating Agencies Face Crackdown", May 18, 2011, available at: http://dealbook.nytimes.com/2011/05/18/rating-agencies-face-crackdown/

[52] "Solicitation of Comment to Assist in Study on Assigned Credit Ratings", SEC Release No. 34-64456 (May 16, 2011), available at: http://www.knowledgemosaic.com/gateway/fedreg/2011-11877.pdf

[53] Id.

One critic of the NRSRO Proposed Rules and their failure to prevent the conflicts of interest inherent in credit ratings agencies' practices who has received much attention is a former senior analyst at Moody's, William J. Harrington, who submitted a comment to the SEC regarding the NRSRO Proposed Rules. His letter containing a "scathing indictment" of Moody's processes, conflicts of interest, and management and stated that the NRSRO Proposed Rules will not fix any of the problems in the credit rating process that led to the financial crash because they do not address the inherent conflict of interest in the current rating process.[54] Harrington alleges that the culture of conflict is so pervasive at Moody's that it often renders ratings useless, as employees are urged to give the clients what they want. [55] Analysts who reach conclusions adverse to the client are viewed, Harrington alleges, as impeding deals and are often transferred, disciplined, harassed or fired. [56] Harrington's statements are similar to findings recently reported by the Senate Permanent Subcommittee on Investigations, that that credit-rating agencies routinely assigned triple-A ratings (the highest grade) to risky securities, and that more than 90% of the triple-A ratings given to mortgage-backed securities in 2006 and 2007 were downgraded to "junk" status.[57] At a subcommittee hearing, representatives from Moody's and S&P said "credit shopping", that is seeking out the agency that would give the highest rating, by investment bankers was common practice and that when credit ratings conflicted with collecting profitable fees the agencies chose the fees.[58] Harrington's evaluation of the NRSRO Proposed Rules is that they will not fix any of the problems with credit agencies and may even make the situation worse.[59] This is because the incentives for management to deliver client-pleasing ratings remain in place, and management has been given the responsibility to create and enforce internal policies and procedures, which Harrington compares to the fox guarding the henhouse. [60]

Another criticism of the NRSRO Proposed Rules is that they are "toothless" since they do not create any real threat of sanction for conflicts of interest and compromising ratings, but only impose fines.[61] A counter-argument is that the performance disclosures mandated by the NRSRO Proposed Rules, the Credit Rating Agency Reform Act of 2006 and various SEC rules already in effect would serve as effective reputational sanctions.[62]

The regulatory agencies have been steadily enacting and proposing regulations to remove references to credit ratings, as mandated by Dodd-Frank. The SEC's proposal to eliminate credit

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[54] Henry Blodget, "Moody's Analyst Breaks Silence: Says Ratings Agency Rotten to Core with Conflicts", August 19, 2011, available at: http://www.businessinsider.com/moodys-analyst-conflicts-corruption-and-greed-2011-8
[55] Id.
[56] Id.
[57] David S. Hilzenrath, "SEC Proposes New Rules for Credit-Rating Firms", May 18, 2011, available at: http://www.washingtonpost.com/business/economy/sec-proposes-new-rules-for-ratings-firms/2011/05/18/AFzPcY6G_story.html
[58] Id.
[59] Id.
[60] Id.
[61] Alison Frankel, "Are SEC's Proposed Credit-Rating Agency Rules 'Toothless?", May 18, 2011, available at: http://newsandinsight.thomsonreuters.com/Legal/NY/News/ViewNews.aspx?id=16614&terms=%40ReutersTopicCodes+CONTAINS+'ANV'
[62] Lin Bai, "The Performance Disclosures of Credit Rating Agencies: Are They Effective Reputational Sanctions?", NYU Journal of Law & Business, Vol. 7, pp. 47-104, 2010, available at: http://scholarship.law.uc.edu/cgi/viewcontent.cgi?article=1008&context=fac_pubs&sei-redir=1#search=%22credit%20agency%20proposed%20rules%20sanctions%22

ratings as a required element for a money market fund to determine whether a security is a permissible investment has been widely criticized. The SEC's proposal is similar to rules proposed in 2008, which were not well received by the financial industry and were never adopted.[63] The current proposed rules would eliminate a uniform, industry-wide objective standard (credit ratings) in favor of a subjective determination of credit worthiness that would be made individually by each fund, which, some critics predict, would leave room for riskier investment strategies by money market funds. This would also very likely create uncertainly in the market, since an issuer would not be certain whether its securities would be accepted by money market funds. The SEC Commissioner Luis A. Aguilar has expressed "serious misgivings" regarding the proposed rules, stating that no appropriate substitute of credit ratings has been proposed and that the costs of the proposed rules would far outweigh the benefits for industry participants and investors alike.[64] Commissioner Aguilar stated that deleting an "external, objective evaluation" and leaving "only the internal, subjective standard is [taking] away a vital investor protection" because it will "create an opportunity for those that will chase yield at the expense of investing in the highest quality securities."[65] Commissioner Aguilar also pointed out the ambiguity and mixed-messages created by the proposed rules in continuing to allow funds to rely on credit ratings as long as they conduct an independent analysis.[66]

III. CONCLUDING REMARKS

More than a year has passed since the enactment of Dodd-Frank; however, we still have a long way to go before we can assess its impacts on the financial markets. Final rules and regulations implementing Dodd-Frank provisions have not yet, in many instances, come into effect, and regulators continue to propose and seek comments from the financial industry regarding many of the most widely anticipated changes contemplated by Dodd-Frank, including risk retention requirements in ABS transactions and the improved regulation of NRSROs. In the meantime, many changes have occurred in the financial markets in reaction to the recent turmoil, including developments such as CMBS 2.0. We can expect to observe further volatility in the markets in the future as investors and industry insiders come to grips with new securitization structures and new regulatory frameworks.

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[63] "References to Ratings of Nationally Recognized Statistical Ratings Organizations", SEC Release No. IC-28327 (July 1, 2008), available at: http://www.sec.gov/rules/proposed/2008/ic-28327.pdf
[64] Speech by SEC Commissioner: Statement at SEC Open Meeting: Allow the Regulators to Regulate by Commissioner Luis A. Aguilar (March 2, 2011), available at: http://www.sec.gov/news/speech/2011/spch030211laa-ratings.htm
[65] Id.
[66] Id.

HERRICK'S DODD-FRANK NEWSLETTER

SEC ADOPTS FINAL INVESTMENT ADVISER RULES PURSUANT TO DODD-FRANK;

DEADLINE FOR ADVISER REGISTRATION EXTENDED TO MARCH 30, 2012

SEC ADOPTS FINAL INVESTMENT ADVISER RULES PURSUANT TO DODD-FRANK; DEADLINE FOR ADVISER REGISTRATION EXTENDED TO MARCH 30, 2012

Recently, the SEC adopted final rules implementing many of the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") relating to the registration of investment advisers. In particular, these rules implement various amendments to the Investment Advisers Act of 1940 (the "Advisers Act") as well as create new exemptions from SEC registration for certain private fund advisers. Though these rules became effective on July 21, 2011, advisers have until March 30, 2012 to comply with applicable registration requirements, unless they qualify for an exemption from SEC registration or are required to register with one or more states. This newsletter summarizes the new rules and their impact on investment advisers. We have also provided a chart of important compliance dates at the end of this newsletter.

I. Rules Implementing Amendments to the Advisers Act[67]

A. Mid-Sized Advisers

The Dodd-Frank Act generally shifts the burden of regulating investment advisers with assets under management below $100 million to the states.[68] Nonetheless, certain advisers with assets under management between $25 million and $100 million ("Mid-Sized Advisers") will be required to register with the SEC under certain circumstances, including if the adviser (i) advises a registered investment company; (ii) advises a business development company; or (iii) is required to register with 15 or more states. Alternatively, pursuant to the SEC's final rules implementing the Dodd-Frank Act's amendments to the Advisers Act, a Mid-Sized Adviser will be required to register with the SEC if it is not subject to registration or examinations in the state where it maintains its principal office and place of business. In practice, this means that Mid-Sized Advisers located in Minnesota, New York and Wyoming must register with the SEC.[69] In addition, Mid-Sized Advisers in other states that are exempt from registration under a state's investment adviser statute will also be required to register with the SEC.[70] A Mid-Sized Adviser that manages only qualifying private funds may be able to rely on the Private Fund Adviser Exemption (see discussion below).

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[67] The SEC's final rules are substantially similar to its proposed rules. See our previous Dodd-Frank Newsletter available here for a more detailed explanation of the SEC's rules.

[68] In its final rules, the SEC revised Item 2.A. of Form ADV to adopt a "buffer" for advisers with close to $100 million in regulatory assets under management. A registered adviser that is filing its annual updating amendment may continue to be registered with the SEC if its has regulatory assets under management of $90 million or more.

[69] See http://sec.gov/divisions/investment/midsizedadviserinfo.htm

[70] Under the SEC's revised instructions to Form ADV, a Mid-Sized Adviser is not "required to be registered" with the state securities authority of the state where it maintains its principal office and place of business, if such adviser is (i) exempt from registration with that state, or (ii) excluded from the definition of "investment adviser" in that state. Accordingly, such Mid-Sized Advisers would be required to register with the SEC.

B. Calculating Regulatory Assets Under Management

The SEC also revised its instructions to Part 1A of Form ADV to implement a uniform method for calculating an adviser's "regulatory assets under management" for purposes of SEC registration, reporting on Form ADV and various exemptions from SEC registration. Generally, advisers must calculate their regulatory assets under management according to the current market value of their assets as measured within 90 days prior to the date of filing their Form ADV. Advisers must also calculate their regulatory assets under management on a gross basis (i.e. without deducting any outstanding indebtedness or other accrued but unpaid liabilities).

The SEC's rules also provide more specific instructions with respect to calculating regulatory assets under management for advisers to private funds. Private fund advisers must now include in their regulatory assets under management (i) the market value of any private fund over which they exercise continuous and regular supervisory or management services, and (ii) the amount of any uncalled capital commitments. In a footnote to the final rules, the SEC stated that it expects advisers to use the same accounting method to determine the fair value of their regulatory assets under management as they use for financial reporting purposes. For example, if an adviser calculated a fund's gross asset values in accordance with U.S. GAAP, then such method could be used for SEC reporting purposes.

C. Exempt Reporting Advisers

The Dodd-Frank Act empowered the SEC to require investment advisers relying on the Private Fund Adviser Exemption and the Venture Capital Fund Exemption (collectively, "Exempt Reporting Advisers") to adhere to certain recordkeeping and reporting requirements. Under the final rules, Exempt Reporting Advisers must report on Form ADV within 60 days of relying on either of these specific exemptions from registration, provided that Exempt Reporting Advisers must submit their initial Form ADV no later than March 30, 2012. More specifically, Exempt Reporting Advisers will be required to disclose information about their regulatory assets under management; organization; and ownership and control. They will also be required to report on their disciplinary history as well as the disciplinary history of their employees. In addition, Exempt Reporting Advisers that advise private funds will be required to provide information for each private fund they advise, including the private fund's size and investment strategy. The SEC stated that it would address applicable recordkeeping requirements for Exempt Reporting Advisers in a forthcoming rule release.

D. Amendments to Form ADV

In response to concerns raised by commenters, the SEC's final rules contain several modifications to the initially proposed amendments to Form ADV. With respect to private fund reporting by registered advisers and Exempt Reporting Advisers, the SEC did not adopt the proposed amendments that would have required Exempt Reporting Advisers (i) to disclose each private fund's net assets; (ii) to report private fund assets and liabilities by class and categorization in the fair value hierarchy established under GAAP; and (iii) to specify the percentage of each fund owned by particular types of beneficial owners. The SEC also revised Part A of Section 7.B.(1) to clarify the definition of "hedge fund." Similarly the SEC revised Part B of Part 7.B.(1) to clarify the instructions and to protect the confidentiality of third parties that value of a private fund's assets on behalf of the adviser.

With respect to custody of client assets, the SEC adopted several clarifications urged by commenters. The SEC clarified Item 9 of Form ADV to specify that Item 9 asks whether an adviser or its related person has custody of funds and securities of clients that are *not* registered investment companies. The SEC also clarified that for purposes of Item 9.B. and 9.C. an adviser must include funds and securities of which a related person has custody in connection with advisory services the adviser provides to clients.

E. Pay-to-Play Rule

The SEC adopted the amendments to the pay-to-play rule largely as proposed, but expanded the category of "regulated persons" excepted from the rule's prohibition on advisers paying third parties to solicit government entities. Specifically, registered municipal advisors are now regulated persons under the rule.

II. Exemptions from Registration

As noted in our earlier Dodd-Frank Newsletter (available here), the Dodd-Frank Act repealed the "private adviser exemption" thereby extending Advisers Act registration to many private fund advisers absent another available exemption. The Dodd-Frank Act also created several new exemptions from SEC registration for investment advisers, which are summarized below:

A. Venture Capital Fund Exemption

The SEC recently adopted rules defining the term "venture capital fund" for purposes of the new exemption from registration added to the Advisers Act by the Dodd-Frank Act, which exempts advisers that advise only venture capital funds from SEC registration (the "Venture Capital Fund Exemption"). Rule 203(l)-1 defines a "venture capital fund" as a private fund[71] that:

[71] Under the Dodd-Frank Act, a "private fund" is defined as a fund that would be required to register as an investment company under the Investment Company Act of 1940, as amended (the "Investment Company Act") but for the exemptions in section 3(c)(1) or section 3(c)(7) thereunder.

(i) holds, immediately after the acquisition of any asset (other than qualifying investments or short-term holdings), no more than 20% of the fund's capital commitments in non-qualifying investments (other than short-term holdings[72]);

(ii) does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, in excess of 15% of the fund's capital contributions and uncalled committed capital, and any such borrowing, indebtedness, guarantee or leverage is for a non-renewable term of no longer than 120 calendar days;

(iii) does not provide investors redemption rights except in "extraordinary circumstances" but that entitles investors generally to receive pro rata distributions;

(iv) represents itself as pursuing a venture capital strategy to its investors and potential investors[73];

(v) is not registered as an investment company under the Investment Company Act of 1940, as amended (the "Investment Company Act") and has not elected to be treated as a business development company.

In its final rule, the SEC expanded the scope of the Venture Capital Fund Exemption in response to several comments it received with respect to the proposed rule. In particular, the SEC eliminated the 20% limit for secondary market transactions that it originally included in the proposed rule and instead adopted a broader 20% limit for assets that are "non-qualifying investments."[74] A venture capital fund would be required under the final rules to measure its compliance with the 20% limit on non-qualifying investments at the time any non-qualifying investment is made, based on the non-qualifying investments then held in the fund's portfolio. The final rules permit the adviser to allocate its non-qualifying investments up to the 20% limit in its discretion, including investments outside of the strict parameters of a fund's qualifying investments. In practice, this would allow venture capital funds to invest a portion of their capital in debt or publicly offered securities, provided that they adhere to the 20% limit for non-qualifying investments at the time each non-qualifying investment is made.

The SEC's final rule includes a grandfathering provision for any private fund that: (i) represented to investors and prospective investors at the time the fund offered its securities that it pursues a venture capital strategy; (ii) has sold securities to one or more investors prior to December 31, 2010; and (iii) does not sell any securities to, including

[72] The SEC's final rule modified the definition of "short-term holdings" to include shares of money market funds that are regulated under rule 2a-7 under the Investment Company Act.
[73] The SEC relaxed the "holding out" criterion of the Venture Capital Fund Exemption to permit a qualifying fund whose name does not include the words "venture capital" to qualify for the Venture Capital Exemption as long as such fund's strategy is not inconsistent with pursing a venture capital strategy.
[74] Under the final rule, qualifying investments are generally equity securities that are directly acquired by a the private fund from a qualifying portfolio company and certain equity securities exchanged by the fund for the directly acquired securities.

accepting any capital commitments from, any person after July 21, 2011 (the "Grandfathering Provision").[75]

The SEC's final rule also contains a note indicating that an adviser may treat any non-U.S. fund that is not offered in the United States, but that would be a private fund if the issuer were to conduct a private offering in the United States, as a "private fund." As such, a non-U.S. fund could be deemed a "venture capital fund" for purposes of the Venture Capital Fund Exemption, provided that the non-U.S. fund meets all of the requirements of such exemption. However, an adviser relying on the Venture Capital Fund Exemption with respect to any non-U.S. fund would be required under the final rule to treat such "private fund" as such under the Advisers Act for all purposes (e.g., reporting by Exempt Reporting Advisers).

In light of these final rules, investment advisers to venture capital funds should review the terms of all fund offering documents to determine whether such terms would disqualify the adviser from relying on the Venture Capital Fund Exemption. For example, an adviser should review whether a fund's strategy is consistent with a venture capital strategy and further, whether a fund's offering documents comply with the Venture Capital Fund Exemption's limits on (i) non-qualifying investments, (ii) borrowing and (iii) redemption rights.

B. Advisers to Private Funds With Less than $150 Million in AUM

As more fully discussed in our earlier Dodd-Frank Newsletter (available here), the Dodd-Frank Act also added a new exemption for advisers to qualifying private funds with less than $150 million in assets under management (the "Private Fund Adviser Exemption"). The final rule would limit the Private Fund Adviser Exemption to those advising "private funds" as defined in the Advisers Act.[76] Accordingly, an adviser managing one separate account would not be eligible for the Private Fund Adviser Exemption, while an adviser with an unlimited number of private fund clients would be eligible for the Private Fund Adviser Exemption, provided that the aggregate value of the assets of the private funds is less than $150 million (using the "regulatory assets under management" criteria described above). However, in response to comments to its proposed rule, the SEC revised the rule to permit an adviser to treat as a private fund any fund that qualifies for another exclusion from the definition of "investment company" under the Investment Company Act (e.g., section 3(c)(5)(C) for certain real estate funds) *in addition to* the exclusions provided by section 3(c)(1) or section 3(c)(7) thereunder. Accordingly, an adviser may rely on the Private Fund Adviser Exemption if it advises a fund that qualifies for more than one exclusion from the definition of "investment company" under the Investment Company Act as long as such fund also qualifies under section 3(c)(1) or 3(c)(7) thereunder

[75] Similar to qualifying funds under the Venture Capital Fund Exemption, a fund relying on the Grandfathering Provision may meet the requirements of the Venture Capital Fund Exemption even if the grandfathered fund's name does not use the words "venture capital" as long as such fund's strategy is not inconsistent with pursuing a venture capital fund strategy.

[76] See footnote 5.

("qualifying private funds"). An adviser relying on this provision, however, must treat the fund as a private fund under the Advisers Act and the rules thereunder for all purposes (e.g., reporting on Form ADV, which requires advisers to report certain information about the private funds they manage).

As applied to non-U.S. advisers, the Private Fund Adviser Exemption would permit an adviser to avoid registration as long as all of the adviser's clients that are U.S. persons are qualifying private funds. A non-U.S. adviser would only need to count the private fund assets it manages at a place of business in the United States toward the $150 million threshold of the Private Fund Adviser Exemption. Accordingly, a non-U.S. adviser that did not manage assets from a U.S. office could manage private funds with an unlimited amount of U.S. investor assets and still qualify for the Private Fund Adviser Exemption.

The SEC's final rule also requires advisers relying on the Private Fund Adviser Exemption to calculate their private fund assets annually in connection with their annual updating amendments to Form ADV, rather than quarterly as proposed. An adviser that reports on its annual updating amendment that it has $150 million or more of private fund assets under management that previously qualified for the Private Fund Adviser Exemption (and complied with all SEC reporting requirements applicable to Exempt Reporting Advisers) may continue to rely on the Private Fund Adviser Exemption up to 90 days after filing the annual updating amendment during the adviser's transition to becoming an SEC-registered adviser. Accordingly, short term fluctuations in fund asset values would not cause a fund manager to lose eligibility for the Private Fund Adviser Exemption as long as such manager was able to stay below the $150 million threshold when it filed its annual updating amendment.

C. Foreign Private Advisers

The Dodd-Frank Act also added a new exemption from SEC registration under the Advisers Act for any investment adviser that (i) has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the investment adviser; (iii) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million; and (iv) does not hold itself out generally to the public in the United States as an investment adviser (the "Foreign Private Adviser Exemption"). The SEC adopted, substantially as proposed, a new rule which defines certain terms contained in the Foreign Private Adviser Exemption. The new rule clarifies that an adviser is not required to count a person as an investor for purposes of the Foreign Private Adviser Exemption if the adviser counts such person as a client of the adviser. As such, a person that is a client of the adviser as well as an investor in a private fund advised by the adviser would only be counted once.

The SEC also revised its treatment of beneficial owners who are "knowledgeable employees" with respect to the private fund, and certain other persons related to such employees (collectively, "knowledgeable employees"). In its proposal, the SEC would have included knowledgeable employees within the definition of "investor;" however, several commenters disagreed with this approach, stating that including such knowledgeable employees in the definition of investor conflicted with previous SEC policy. In consideration of these comments, the SEC's final rule will exclude knowledgeable employees from the definition of "investor" for purposes of the Foreign Private Adviser Exemption.

III. Family Office Exemption

On June 22, 2011, the SEC adopted the rules defining the "family office exclusion" added to the Advisers Act by the Dodd-Frank Act. Advisers that qualify as a family office are excluded from the definition of an investment adviser under the Advisers Act and are exempt from all registration and reporting requirements thereunder. Specifically, the SEC's rule defines the term "family office" and sets forth the specific elements of the family office exclusion. Though the SEC significantly expanded the scope of the exemption from its original proposal (click here to view a Client Alert we prepared summarizing the proposed rule), the SEC did not incorporate several comments it received into the final rule, particularly those urging that the SEC apply the exclusion to multi-family offices.

Generally, the SEC expanded the family office exclusion by enlarging the concept of "family member" in the final rule. First, the SEC allowed a family office to include as "family members" all lineal descendants of a common ancestor; provided, however, that there can be no more than 10 generations removed from the youngest generation of family members. In practice, this would allow an adviser to designate a common ancestor and in turn, determine the family members who can be advised by the family office. Further, a family office would be free to choose new common ancestors as older generations pass away. In addition, the SEC expanded the definition of family member to include former spouses and adopted, foster and stepchildren.

The SEC also expanded the concept of who is a key employee of the family office. Under the rule, a family office (the "First Family Office") can provide investment advice to any key employee of the First Family Office, including any person who is a key employee of an affiliated family office (the "Affiliated Family Office"). While the rule would not allow the First Family Office to provide advice to *any* employees of any Affiliated Family Office, it would allow the First Family Office to provide investment advice to a *key employee* of an Affiliated Family Office, provided that the Affiliated Family Office is (i) wholly-owned by family clients of the First Family Office, (ii) is controlled by family members of First Family Office (or controlled by family entities affiliated with the First Family Office), and (iii) has no clients other than family clients of the First Family Office. In addition, the SEC also extended the period during which a family office may continue to provide investment advice to non-family clients who receive assets through an involuntary transfer such as a bequest from 4 months to 1 year.

As a result of this rule, some existing family offices may need to restructure their operations to rely on the rule's exclusion from registration, or seek exemptive relief from the SEC. In particular, a family office may not qualify for the exclusion if it also advises non-family or non-key employee clients. A family office that cannot meet the requirements of the family office exclusion will be required to register with the SEC as an investment adviser by March 30, 2012, unless the family office qualifies for another exemption from SEC registration.

IV. Adjustments to "Qualified Client" Test

A. Increase in Dollar Amount Thresholds in Rule 205-3

The SEC recently issued an order that implements the Dodd-Frank Act's adjustment for inflation of the two dollar amount tests in Rule 205-3 under the Advisers Act, which permits an investment adviser to charge certain qualifying clients a performance fee which would otherwise be prohibited under such Act.[77] Under this rule, an adviser may charge performance fees if, among others, the client has at least $750,000 under the management of such adviser immediately after entering into the advisory contract (the "AUM Test") or if the adviser reasonably believes the client has a net worth of more than $1,500,000 at the time the contract is entered into (the "Net Worth Test"). The SEC has not revised the dollar amount thresholds contained in the AUM Test and the Net Worth Test since 1998.

The Dodd-Frank Act amended section 205(e) of the Advisers Act to require the SEC to adjust the dollar amount thresholds in the AUM Test and the Net Worth Test in Rule 205-3 promulgated under section 205(e) of the Advisers Act for inflation by July 21, 2011 and every five years thereafter. In its order, the SEC revised the dollar amount threshold in the AUM Test from $750,000 to $1,000,000 and in the Net Worth Test from $1,500,000 to $2,000,000. These new dollar amount thresholds will be effective as of September 19, 2011. These new dollar amount thresholds will particularly impact registered investment advisers managing private funds relying on the section 3(c)(1) exemption under the Investment Company Act by raising the bar of investor eligibility (assuming that such funds are charging performance fees to investors).

B. Other Proposed Amendments to Rule 205-3

In connection with its notice of intent to raise the dollar amount thresholds in Rule 205-3, the SEC also proposed three other significant amendments to Rule 205-3. These proposed rules would (i) require the SEC to adjust the dollar thresholds in the AUM Test and the Net Worth Test every five years; (ii) exclude the value of a natural person's primary residence for purposes of the Net Worth Test (similar to other Dodd-Frank provisions and related SEC rules amending the definition of "accredited investor" under Regulation D of the Securities Act of 1933); and (iii) implement transition rules allowing investment advisers to maintain existing performance fee arrangements that complied with Rule 205-3 as in effect when the client entered into the advisory contract or that were entered into before the adviser registered with the SEC.

[77] Rule 205-3 provides that the prohibition on advisers charging performance based compensation to clients contained in Section 205(a)(1) of the Advisers Act shall not apply in the case of persons who are "qualified clients" under the Rule. Under paragraph (b) of the Rule, each investor in a private fund that charges performance fees is considered a client for purposes of the Rule.

HERRICK'S DODD-FRANK CHARTS

CHARTS SUMMARIZING REGULATORY DEVELOPMENTS WITH RESPECT TO DODD-FRANK UPDATED THOUGH SEPTEMBER 7, 2011

CHARTS SUMMARIZING REGULATORY DEVELOPMENTS WITH RESPECT TO DODD-FRANK UPDATED THOUGH SEPTEMBER 7, 2011

Deadline	Action
July 21, 2011	• Amendments to section 203A(a)(2) became effective. • Mid-Sized Advisers applying for SEC registration may register with the SEC or the appropriate state securities authority.
January 1, 2012	• SEC-registered Mid-Sized Advisers must remain registered with the SEC until this date, unless they are relying on an exemption from SEC registration
February 14, 2012	• Advisers that previously relied on private adviser exemption should file their Form ADV with SEC to assure acceptance by March 30, 2012 deadline as initial applications for registration can take up to 45 days to be approved
March 30, 2012	• Each SEC-registered adviser (regardless of AUM) must file an amendment to its Form ADV with the SEC • Exempt Reporting Advisers (those advisers relying on the Venture Capital Fund Exemption or the Private Fund Adviser Exemption from SEC registration) must submit their initial Form ADV to the SEC
June 28, 2012	• Mid-Sized Advisers no longer eligible for SEC registration and SEC-registered advisers choosing to rely on one of the new exemptions from registration (i.e., the Venture Capital Fund Exemption, Private Fund Adviser Exemption, Foreign Private Adviser Exemption) must file Form ADV-W with SEC and file the appropriate registration documents with the relevant state authority, if applicable

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT[78]
Title I: Financial Stability

Section	Status	Effective Date; Compliance Date(s)
Section 102(b) - Definitions - Requirements for determining if a company is predominantly engaged in financial activities (for purposes of defining nonbank financial companies to be supervised by the Federal Reserve)	Notice of Proposed Rulemaking (Federal Reserve System, Docket No. R-1405) - Definition of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company (comments period closed)	
	Notice of Proposed Rulemaking (Financial Stability Oversight Council, RIN 4030-AA00) - Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (comments period closed)	
Section 120(e)(2)(B) - Financial Stability Oversight Council - Additional standards applicable to activities or practices for financial stability purposes - Procedures for appealing decisions of financial regulators		
Section 121(d) - Financial Stability Oversight Council - Mitigation of Risks to Financial Stability - application of section to foreign financial companies		
Section 152(g) - Office of Financial Research - Certain post-employment prohibitions for Director and other employees of Office of Government Ethics		
Section 153 - Office of Financial Research		
Section 154(b)(1)(C) - Office of Financial Research -Type and scope of data to be collected by Data Center of the Office of Financial Research		
Section 155(d) - Office of Financial Research - Assessment schedule to fund the Financial Research Fund established in the Treasury		
Section 165 - Enhanced Supervision and Prudential Standards for Nonbank Financial Companies and Bank Holding Companies supervised by Federal Reserve		

[78] This chart summarizes regulatory developments with respect to Dodd-Frank though September 7, 2011.

Section 165(b)(1)(A); 165(b)(1)(B) - Prudential standards for companies supervised by Federal Reserve (including risk-based capital requirements, leverage limits, liquidity requirements, overall risk management requirements, resolution plan and credit exposure report requirements, and concentration limits)	Proposed Rule (Federal Reserve System, Docket No. R-1425) - Capital Plans (comments period closed)	
Section 165(d)(1)(D) - Additional information required in periodic reports to Federal Reserve		
Section 165(d)(8) - Implementing regulations for this subsection (Resolution Plan and Credit Exposure Reports)	Proposed Rule (Federal Reserve System, FDIC; RIN 3064-AD77) - Resolution Plans and Credit Exposure Reports Required (comments period closed)	
Section 165(c)(1) - Requirement for companies supervised by Federal Reserve to maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress		
Section 165(e)(1) - Standards to limit risk of failure by any individual company supervised by Federal Reserve		
Section 165(e)(3)(F); (e)(6) - Additions to definition of "credit exposure"		
Section 165(e)(5) - Rules necessary to administer and carry out this section (Concentration Limits)		
Section 165(f) - Periodic public disclosures by companies supervised by Federal Reserve		
Section 165(g)(1); (g)(3) - Limit on short-term debt for companies supervised by Federal Reserve		
Section 165(h)(2)(A); (h)(4) - Requirement for risk committee for each bank holding company that is a publicly traded company and that has total consolidated assets of not less than $10 billion		
Section 165(h)(2)(B)- Requirement for risk committee for each bank holding company that is a publicly traded company and that has total consolidated assets of less than $10 billion to		
Section 165(i)(2)(C) - Implementing regulations regarding stress tests	Proposed Joint Guidance (OCC, Federal Reserve System, FDIC; OCC Docket No. OCC-2011-0011) - Proposed Guidance on Stress Testing for Banking Organizations with More than $10 Billion in Total Consolidated Assets	

Section 165(j)(3) - Procedures and timelines for complying with leverage limitations		
Section 165(k)(3) - Additions to definition of “off-balance-sheet activities” for purposes of this section (Enhanced Supervision and Prudential Standards for Companies Supervised by Federal Reserve)		
Section 166(a) - Early remediation of financial distress of companies supervised by Federal Reserve		
Section 167(c)(2) - Criteria for determining whether to require a nonbank financial company supervised by Federal Reserve to establish an intermediate holding company		
Section 167(c)(2) - Restrictions or limitations on transactions between an intermediate holding companies or a nonbank financial companies supervised by Federal Reserve and their affiliates, as necessary to prevent unsafe and unsound practices		
Section 170(a) - Exemption of certain types or classes of U.S. or foreign nonbank financial companies from supervision by Federal Reserve		
Section 171(b)(1) - Minimum leverage capital requirements for companies supervised by Federal Reserve		
Section 171(b)(2) - Minimum risk-based capital requirements for companies supervised by Federal Reserve	Final Rule (OCC, Federal Reserve System, FDIC; FDIC RIN 3064-AD58) - Risk-Based Capital Standards: Advanced Capital Adequacy Framework - Basel II; Establishment of a Risk-Based Capital Floor	Effective Date: July 28, 2011
	Final Rule (Federal Reserve System, Docket No. R-1356) - Capital Adequacy Guidelines; Small Bank Holding Company Policy Statement: Treatment of Subordinated Securities Issued to the United States Treasury under the Emergency Economic Stabilization Act of 2008 and the Small Jobs Act of 2010	Effective Date: June 21, 2011

Section	Status	Effective Date; Compliance Date(s)
Section 201(b); Section 210(c)(8)(D)(i); Section 210(c)(8)(D)(ii)(II); Section 210(c)(8)(D)(v)(I); Section 201(c)(9)(D)(i) - Definitional criteria for "financial company", "qualified financial contracts", "securities contract", "repurchase agreement", "financial institution"		
Section 202(d)(5) - Judicial Review - Regulations governing termination of receiverships		
Section 205(h) - Judicial Review - Rules to implement section (Orderly Liquidation of Covered Brokers and Dealers)		
Section 209 - Regulations implementing Title II (including with respect to rights, interests and priorities of creditors, counterparties or other persons)		
Section 210 - Powers and duties of the FDIC		
Section 210(a)(7)(d) - Rules regarding payment of post-insolvency interest to creditors		
Section 210(c)(3)(E) - Rules regarding compensatory damages		
Section 210(c)(8)(H)(i) - Requirement for financial companies to maintain records re: qualified financial contracts (including market valuations)		
Section 210(n)(7) - Calculation of maximum obligation to be incurred by the FDIC		
Section 210(o)(6)(A) - Regulations to implement subsection (assessment to pay for obligations issued by FDIC)		
Section 210(r)(1) - Regulations prohibiting certain sales of assets of covered financial companies		
Section 210(s)(3) - Recoupment of Compensation from Senior Executives and Directors - Rules implementing subsection		
Section 213(d) - Ban on Certain Activities by Senior Executives and Directors - Rules and regulations implementing section		

Section	Status	Effective Date; Compliance Date(s)
Title III - Transfer of Powers to the OCC, FDIC and Federal Reserve		
Section 311, 312, 316, 318 - Powers and Duties Transferred from Office of Thrift Supervision to OCC and FDIC		
Section 331 - Deposit Insurance Reforms	Notice of Proposed Rulemaking (FDIC, RIN 3064-AD66) - Assessments, Large Bank Pricing (comments period closed)	
Section 331(b) - Amendment to Federal Deposit Insurance Act - Change to assessment base for penalties for providing inaccurate information in reports to the FDIC		
Section 332 - Amendment to Federal Deposit Insurance Act - Change method for refunding excess assessments	Final Rule (FDIC, RIN 3064-AD66) - Assessments, Large Bank Pricing	Effective Date: April 1, 2011
	Final Rule (FIDC, RIN 3064-AD69) - Designated Reserve Ratio	Effective Date: January 1, 2011
Section 355 - Amendment to Bank Holding Company Act Amendments of 1970 - Implementing regulations	Final Rule (National Credit Union Administration, RIN 3133-AD78) - Display of Official Sign; Permanent Increase in Standard Maximum Share Insurance Amount	
Section 343 - Insurance of Transaction Accounts	Notice of Proposed Rulemaking (FDIC, RIN 3064-AD78) - Interest on Deposits; Deposit Insurance Coverage (comments period closed)	
	Final Rule (FDIC, RIN 3064-AD37) - Deposit Insurance Regulations; Unlimited Coverage for Noninterest-Bearing Transaction Accounts; Inclusion of Interest on Lawyers Trust Accounts	Effective Date: January 27, 2011
	Final Rule (FDIC, RIN 3064-AD65) - Deposit Insurance Regulations; Unlimited Coverage for Noninterest-Bearing Transaction Accounts	Effective Date: December 31, 2010
	Proposed Rule (National Credit Union Administration, RIN 3133-AD79) - Share Insurance and Appendix (comments period closed)	
Section 358(2) - Amendment to Community Reinvestment Act - Implementing regulations		

Section	Status	Effective Date; Compliance Date(s)
Amendments to Investment Advisers Act of 1940		
Section 402(a) - Amendments to Investment Advisers Act - Certain changes to definition of "foreign private adviser"	Final Rule (SEC Release No. IA-3222) - Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers	Effective Date: July 21, 2011
Section 404(2) - Amendments to Investment Advisers Act - Rules regarding scope of information to be provided to SEC by private fund advisers		
Section 403 - Elimination of Private Adviser Exemption; Limited Exemption for Foreign Private Advisers; Limited Intrastate Exemption	Final Rule (SEC, Release No. IA-3221) - Rule Implementing Amendments to the Investment Advisers Act of 1940	Effective Date: September 19, 2011; Compliance dates vary
	Final Rule (SEC Release No. IA-3222) - Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers	Effective Date: July 21, 2011
Section 404 - Collection of Systemic Risk Data; Reports, Examinations, Disclosures	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD30) - Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations (comments period closed)	
	Joint Proposed Rules (CFTC, SEC, Release No. IA-3145) - Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF (comments period closed)	
Section 406(2) - Amendments to Investment Advisers Act - Rules regarding form and content of reports to be filed by investment advisers with the SEC and CFTC	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD30) - Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations (comments period closed)	
	Joint Proposed Rules (CFTC, SEC, Release No. IA-3145) - Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF (comments period closed)	

Section 407 - Amendments to Investment Advisers Act - Exemptions of and Reporting by Venture Capital Fund Advisers - Definition of "venture capital fund"	Final Rule (SEC, Release No. IA-3221) - Rule Implementing Amendments to the Investment Advisers Act of 1940	Effective Date: September 19, 2011; Compliance dates vary
	Final Rule (SEC Release No. IA-3222) - Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers	Effective Date: July 21, 2011
Section 408 - Amendments to Investment Advisers Act - Reporting requirements for investment advisers to private funds who are exempt from registration	Final Rule (SEC, Release No. IA-3221) - Rule Implementing Amendments to the Investment Advisers Act of 1940	Effective Date: September 19, 2011; Compliance dates vary
	Final Rule (SEC Release No. IA-3222) - Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers	Effective Date: July 21, 2011
Section 409 - Amendments to Investment Advisers Act - Definition of "family office"	Final Rule (SEC Release No. IA-3220) - Family Offices	Effective Date: August 29, 2011
Section 410 - State and Federal Responsibilities; Asset Threshold for Federal Registration of Investment Advisers	Final Rule (SEC, Release No. IA-3221) - Rule Implementing Amendments to the Investment Advisers Act of 1940	Effective Date: September 19, 2011; Compliance dates vary
Section 411 - Amendments to Investment Advisers Act - Custody of Client Accounts - Rules regarding protection of client assets		
Section 413(a) - Adjusting the Accredited Investor Standard	Proposed Rule (SEC, Release Nos. 33-9177; IA-3144; IC-29572) - Net Worth Standard for Accredited Investors (comments period closed)	
Section 413(b)(1)(B); 413(b)(2)(B) - Periodic review of and changes to definition of "accredited investor"		
Section 418 - Amendments to Investment Advisers Act - Inflation adjustment to performance based compensation charged to qualified client standard	Order (SEC Release No. 3236) - Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 Under the Investment Advisers Act of 1940	Effective Date: September 19, 2011
	Proposed Rule (SEC Release no. IA-3198) - Investment Adviser Performance Compensation (comments period closed)	

DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT
Title VI: Improvements to Regulation of Bank and Savings Association Holding Companies and Depository Institutions

Section	Status	Effective Date; Compliance Date(s)
Section 603 - Moratorium on Treatment of Credit Card Banks, Industrial Loan Companies, and Certain Other Companies Under Bank Holding Company Act of 1956 - three year moratorium on approving certain changes in control of credit card banks, industrial banks and trust bank	Final Rule (OCC, RIN 1557-AD41) - Office of Thrift Supervision Integration; Dodd-Frank Act Implementation	Effective Dates vary
Section 608(a) - Enhancing Existing Restrictions on Bank Transactions with Affiliates - Manner in which netting agreements may be taken into account in determining the amount of the covered transaction		
Section 615 - Limitations on Purchases of Assets from Insiders (applies to insured depository institutions) - Implementing regulations		
Section 616(d) - Amendments to Federal Deposit Insurance Act - Implementing regulations - Source of strength		
Section 618 (b)(2)(A) - Securities holding companies - Registration requirements for securities holding companies that elect to be subject to comprehensive consolidated supervision	Proposed Rule (Federal Reserve System, RIN 7100-AD81) - Supervised Securities Holding Companies Registration (comments due on or before October 11, 2011)	
Section 618 (d)(1) - Securities holding companies - Capital and other risk management standards		
Section 618 (e)(2) - Securities holding companies - Exceptions to application of Bank Holding Company Act of 1965 to supervised securities holding companies		
<u>Volker Rule (Section 619)</u>		
Section 619 - Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds - Implementing regulations	Final Rule (Federal Reserve System, Docket No. R-1397) - Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities	Effective Date: April 1, 2011
Section 619 - Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds - Discretionary extension of deadline for divesture for banks and nonbank financial companies supervised by Federal Reserve		

Section 619 - Prohibitions on Proprietary Trading and Certain Relationships with Hedge Funds and Private Equity Funds - Additions to list of permitted activities		
Section 621 - Conflicts of Interest Relating to Certain Securitizations - Implementing regulations		
Section 623(a), 623(b), 623(c) - Interstate Merger Transactions - Definition of "home office" with respect to federal savings associations		
Section 622 - Concentration Limits on Large Financial Firms - Implementing regulations		
Section 622 - Concentration Limits on Large Financial Firms - Definition of "liabilities" for insurance companies and other nonbank financial companies supervised by Federal Reserve		
Section 626(c)(1) - Intermediate Holding Companies - Criteria for determining whether to require a grandfathered unitary savings and loan holding company to establish an intermediate holding company		
Section 626(c)(2) - Intermediate Holding Companies - Restrictions or limitations on transactions between intermediate holding company or a parent of such company and its affiliates		
Section 627 - Interest-Bearing Transaction Accounts Authorized - Repeal of prohibition on payment of interest on demand deposits	Final Rule (Federal Reserve System, Docket No. R-1413) - Prohibition Against Payment of Interest on Demand Deposits	Effective Date: July 21, 2011
	Final Rule (FDIC, RIN 3064-AD78) - Interest on Deposits; Deposit Insurance Coverage	Effective Date: July 21, 2011

Section	Status	Effective Date; Compliance Date(s)
REGULATION OF OVER-THE-COUNTER SWAPS MARKETS	Concept Release (SEC, Release No. IC-29776) - Use of Derivatives by Investment Companies under the Investment Company Act of 1940 (comments due before November 7, 2011)	
	Proposed Rules (National Futures Association) - Leverage Transaction Merchants Capital Requirements - Proposed Amendments to NFA Financial Requirements Section 6	
Section 712(a)(8) - Mixed Swaps - Regulations regarding mixed swaps		
Section 712(d)(1), 712(d)(2)(A), 719(d)(1)(B), 721(a)(5), 721(a)(10), 721(a)(13), 721(a)(15), 721(a)(16), 721(a)(21), 721(b) - Definitions - Definitions of "swap" and whether stable value contracts fall within the definition of a swap, "security-based swap, "swap dealer" and de minimus exemption from designation as swap dealer, "security-based swap dealer", "major swap participant" and "substantial position" for the purpose of defining major swap participant, "major security-based swap participant", "eligible contract participant", "security-based swap agreement", "commercial risk", "commodity pool", "floor broker", "futures commission merchant", "introducing broker", "agricultural commodity" and other definitions that are necessary and appropriate, in the public interest and for the protection of investors	Joint Proposed Rules (CFTC, SEC, Release No. 33-9204) - Further Definition of "Swap", "Security-Based Swap" and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (comments period closed)	
	Final Rule (CFTC, RIN 3038-AD23) - Agricultural Commodity Definition	Effective Date: September 12, 2011
Section 714 - Abusive Swaps - CFTC and SEC may collect information concerning markets for swaps and security-based swaps and determine which types are detrimental to the stability of a financial market or participants in a financial market		

Section 721(a)(21) - Foreign Exchange Swaps and Foreign Exchange Forwards - Timelines for reporting foreign exchange swaps and foreign exchange forwards to CFTC (if there is no swap data repository that would accept such swap or forward)		
Section 723 - Clearing	Advance Notice of Proposed Rulemaking (National Credit Union Administration) - Financial Derivatives Transactions to Offset Interest Rate Risk; Investment and Deposit Activities (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD18) - Core Principles and Other Requirements for Swap Execution Facilities (comments period closed)	
	Proposed Rule (CFTC, RIN 3038-AD10) - End-User Exception to Mandatory Clearing for Swaps (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD09) - Core Principles and Other Requirements for Designated Contract Markets (comments period closed)	
Section 723(a)(3) - Clearing - Rules for derivatives clearing organizations' submission for review by CFTC of each swap, or group/category/type/class of swap, that is seeks to accept for clearing or has accepted for clearing	Final Rule (CFTC, RIN 3038-AD21) - Agricultural Swap	Effective Date: December 31, 2011
	Final Rule (CFTC, RIN 3038-AD00) - Process for Review of Swaps for Mandatory Clearing	Effective Date: September 26, 2011
	Final Rule (CFTC, RIN 3038-AD23) - Agricultural Commodity Definition	Effective Date: September 12, 2011
Section 723(a)(3) - Clearing - Rules for reporting to a registered swap repository or CFTC swaps entered into after enactment of Dodd-Frank (June 21, 2010) but before effectiveness of final rules	Interim Final Rule (CFTC, RIN 3038-AD29) - Reporting Certain Post-Enactment Swap Transactions	Effective Date: December 17, 2010
Section 723(a)(3) - Clearing - Rules for reporting to a registered swap repository or CFTC swaps entered into before enactment of Dodd-Frank (June 21, 2010)		

Section 724(a) - Segregation of Assets Held as Collateral In Swap Transactions; Permitted Investments for Assets Held as Collateral In Swap Transactions	Advanced Notice of Proposed Rulemaking (CFTC, RIN 3038-AD99) - Protection of Cleared Swaps Customers Before and After Commodity Broker Bankruptcies (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD28) - Protection of Collateral of Counterparties to Uncleared Swaps; Treatment of Securities in a Portfolio Margining Account in a Commodity Broker Bankruptcy (comments period closed)	
Section 725(b) - Annual Reports by Chief Compliance Officer of Derivatives Clearing Organization		
Section 725(c) - Core Principles for Derivatives Clearing Organization	Proposed Rule (CFTC, RIN 3038-AC98) - Risk Management Requirements for Derivatives Clearing Organizations (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD01) - Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding Mitigation of Conflicts of Interest (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD98) - Financial Resources Requirements for Derivatives Clearing Organizations (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD98) - General Regulations for Derivatives Clearing Organizations (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD98) - Information Management Requirements for Derivatives Clearing Organizations (comments period closed)	

Section 725(d) - Conflicts of Interest - Rules mitigating conflicts of interest in connection with the conduct of business by a swap dealer or a major swap participant with a derivatives clearing organization, board of trade, or a swap execution facility that clears or trades swaps in which the swap dealer or major swap participant has a material debt or material equity investment		
Section 726(a) - Conflicts of Interest - Rules which may include limits on control of, or the voting rights with respect to, any derivatives clearing organization that clears swaps, swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading, by certain systemically important banking and financial institutions	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD01) - Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding Mitigation of Conflicts of Interest (comments period closed)	
Section 727 - Public Reporting of Swap Transaction Data - Rules regarding public availability of swap transaction and pricing data	Final Rule (CFTC, RIN 3038-AD20) - Swap Data Repositories: Registration Standards, Duties and Core Principles	Effective Date: October 31, 2011
Section 728 - Swap Data Repositories - Standards specifying type of data for each swap that shall be collected and maintained by swap data repositories; regulation of swap data repositories	Final Rule (CFTC, RIN 3038-AD20) - Swap Data Repositories: Registration Standards, Duties and Core Principles	Effective Date: October 31, 2011
Section 728 - Annual Report of Chief Compliance Officer of Swap Data Repositories		
Section 729 - Reporting and Recordkeeping - Rules providing for reporting of each swap entered into before the date of enactment of Dodd-Frank (June 21, 2010) and after date of enactment, but before effectiveness of final rules	Interim Final Rule (CFTC, RIN 3038-AD29) - Reporting Certain Post-Enactment Swap Transactions	Effective Date: December 17, 2010
Section 729 - Reporting and Recordkeeping - Timeline for reporting to CFTC each swap not accepted for clearing by any derivatives clearing organization		
Section 730 - Large Swap Trader Reporting - Regulations regarding reporting of all swaps and any transactions and positions in any related commodity traded on or subject to the rules of any designated contract market or swap execution facility, and of cash or spot transactions in, inventories of, and purchase and sale commitments of, such a commodity		
Section 730 - Large Swap Trader Reporting		

Section 731 - Registration and Regulation of Swap Dealers and Major Swap Participants	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD98) - Requirements for Processing, Clearing and Transfer of Customer Positions	
• Rules governing reporting and recordkeeping for swap dealers and major swap participants	Notice of Proposed Rule Rulemaking (CFTC, RIN 3038-AC96) - Swap Trading Relationship Documentation Requirements for Swap Dealers and Major Swap Participants (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AC96) - Confirmation, Portfolio Reconciliation, and Portfolio Compression Requirements for Swap Dealers and Major Swap Participants (comments period closed)	
• Rules regarding registration of swap dealers and major swap participants		
• Business conduct standards for swap dealers and major swap participants	Notice of Proposed Rulemaking (CFTC, RIN 3038-AC96) - Implementation of Conflicts of Interest Policies and Procedures for Swap Dealers and Major Swap Participants (comments period closed)	
• Capital requirements and margin requirements for swap dealers and major swap participants	Proposed Rules (OCC, Board of Governors of Federal Reserve System, FDIC, Farm Credit Administration, Federal Housing Finance Agency; Docket No. OCC-2011-0008) - Margin and Capital Requirements for Covered Swap Entities (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AC97) - Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants (comments period closed)	
• Rules governing duties of swap dealers and major swap participants	Notice of Proposed Rulemaking (CFTC, RIN 3038-AC96) - Regulations Establishing and Governing the Duties of Swap Dealers and Major Swap Participants (comments period closed)	
• Rules governing daily trading records for swap dealers and major swap participants		

• Rules governing documentation standards for swap dealers and major swap participants	Proposed Rule (CFTC, RIN 3038-AC96) Orderly Liquidation Termination Provision in Swap Trading Relationship Documentation for Swap Dealers and Major Swap Participants (comments period closed)	
Section 733 - Swap Execution Facilities - Rules defining universe of swaps that can be executed on a swap execution facility		
Section 733 - Swap Execution Facilities - Regulations of alternative swap execution facilities	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD01) - Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Additional Requirements Regarding Mitigation of Conflicts of Interest (comments period closed)	
Section 733 - Annual Reports by Chief Compliance Officer of Swap Execution Facilities		
Section 737(a)(4) - Position Limits - Limits on the amount of positions (other than bona fide hedge positions) that may be held by any person with respect to contracts of sale for future delivery or with respect to options on the contracts or commodities traded on or subject to the rules of a designated contract market		
Section 737(a)(4) - Position Limits - Limits (including related hedge exemption provisions) on the aggregate number or amount of positions in contracts based upon the same underlying commodity that may be held by any person	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD15) - Position Limits for Derivatives (comments period closed)	
Section 738(a)(4) - Registration Requirements for Foreign Boards of Trade	Notice of Proposed Rulemaking (CFTC, RIN 3038-AC19) - Registration of Foreign Boards of Trade (comments period closed)	
Section 742(a)(2) - Retail Commodity Transactions - Certain exceptions to requirements prescribed for retail commodity transactions under Commodity Exchange Act		
Section 742(c) - Retail Foreign Exchange Transactions	Notice for Proposed Rulemaking (Federal Reserve System, Docket No. R-1428) - Retail Foreign Exchange Transactions (Regulation NN) (comments ends October 11, 2011)	

	Interim Final Temporary Rule (SEC, Release No. 34-64874) - Retail Foreign Exchange Transactions	Effective Date: from July 15, 2011 until July 16, 2012; Compliance Date: September 13, 2011
	Final Rule (FDIC, RIN 3064-AD81) - Retail Foreign Exchange Transactions	Effective Date: July 15, 2011
	Final Rule (CFTC, RIN 3038-AC61) - Regulation of Off-Exchange Retail Foreign Exchange Transactions and Intermediaries	Effective Date: October 18, 2010
Section 745(b) - Derivative Clearing Organizations - Criteria, conditions or rules under which CFTC will determine initial eligibility or continuing qualification of a derivatives clearing organization to clear swaps	Final Rule (CFTC, RIN 3038-AD07) - Provisions Common to Registered Entities	Effective Date: September 26, 2011
	Final Rule (CFTC, RIN 3038-AD00) - Process for Review of Swaps for Mandatory Clearing	Effective Date: September 26, 2011
Section 747 - Disruptive Practices - Regulations to prohibit disruptive trading practices	Advance Notice of Proposed Rulemaking (CFTC, RIN 3038-AD26) - Antidisruptive Practices Authority (comments period closed)	
Section 748 - Commodity Whistleblower Incentives and Protections - Definition of "whistleblower"; Implementing regulations	Final Rules (CFTC, RIN 3038-AD04) - Final Whistleblower Incentives and Protection	Effective Date: October 24, 2011
Section 753 - Fraud and Manipulation	Final Rules (CFTC, RIN 3038-AD27) - Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation	Effective Date: August 15, 2011
REGULATION OF SECURITY-BASED SWAP MARKETS		
Section 761 - Definitions - Definition of "substantial position" for purposes of defining, de minimus exemption from designation as security-based swap dealer, "security-based swap", "security-based swap dealer", "major security-based swap participant", "eligible contract participant" with regard to security-based swaps, "commercial risk" with regard to security-based swaps	Joint Proposed Rules (CFTC, SEC, Release No. 33-9204) - Further Definition of "Swap", "Security-Based Swap" and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping (comments period closed)	
Section 763(a) - Anti-evasion rules - Rules to prevent evasions of mandatory clearing requirements		

Section 763(a) - Clearing - Rules to prevent abuse of exceptions to clearing requirement for security-based swaps		
Section 763(a) - Clearing - Rules for a clearing agency's submission for review of security-based swap, or a group/category/type/class of security-based swaps, that it seeks to accept for clearing	Proposed Rules (SEC, Release Nos. 33-9222; 34-64639) - Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies (comments period closed)	
	Proposed Rule (SEC, Release No. 34-63557) - Process for Submission for Review of Security-Based Swaps for Mandatory Clearing and Notice of Filing Requirements for Clearing Agencies (comments period closed)	
	Proposed Rules (SEC, Release No. 34-63346) - Regulation of SBSR - Reporting and Dissemination of Security-Based Swap Information (comments period closed)	
Section 763(a) - Annual Reports by Chief Compliance Officer of Registered Clearing Agency		
Section 763(b) - Clearing Agencies - Rules governing registered clearing agencies for security-based swaps	Interim final rule (SEC), 17 CFR Parts 240 and 249 - Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies	Effective Date: July 15, 2011
	Final Rule (SEC, Release No. 34-64628) - Beneficial Ownership Reporting Requirements and Security-Based Swaps	Effective Date: July 16, 2011
	Proposed Rule (SEC, Release No. 34-64017) - Clearing Agency Standards for Operation and Governance (comments period closed)	
Section 763(c) - Security-Based Execution Facilities - Regulation of security-based swap execution facilities	Proposed Rule (SEC, Release No. 34-63825) - Registration and Regulation of Security-Based Swap Execution Facilities (comments period closed)	
Section 763(c) - Annual Reports by Chief Compliance Officer of Security-Based Swap Execution Facilities		
Section 763(d) - Segregation of Assets Held as Collateral In Security-Based Swap Transactions		
Section 763(d) - Permitted Investments for Assets Held as Collateral In Security-Based Swap Transactions		

Section 763(g) - Fraudulent and Deceptive Practices - Regulations to define and prevent transactions, acts, practices and courses of business that are fraudulent, deceptive, or manipulative, and fictitious quotations	**Proposed Rule** (SEC), 17 CFR Part 49 - Prohibition Against Fraud, Manipulation, and Deception in Connection with Security-Based Swaps (comments period closed)	
Section 763(h) - Position Limits - Regulations establishing limits (including related hedge exemption provisions) on the size of positions in any security-based swap that may be held by any person; regulations establishing exemptions form such position limits		
Section 763(h) - Large Trader Reporting - Rules requiring any person that effects transactions for such person's own account or the account of others in any security-based swap or uncleared security-based swap and any security or loan or group or narrow-based security index of securities or loans to report such information to the SEC	Final Rule (CFTC, RIN 3038-AD17) - Large Trader Reporting for Physical Commodity Swaps	Effective Date: September 20, 2011
Section 763(i) - Standards for Clearing Agencies Clearing Security-Based Swap Transactions	Proposed Rule (SEC, Release No. 34-64017) - Clearing Agency Standards for Operation and Governance (comments period closed)	
Section 763(i) - Public Reporting and Repositories for Security-Based Swaps - Rules regarding public availability of security-based swap transaction, volume and pricing data		
Section 763(i) - Annual Report by Chief Compliance Officer of Security-Based Data Repositories		
Section 764 - Regulations and Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants		
• Rules governing reporting and recordkeeping for security-based swap dealers and major security-based swap participants		
• Rules regarding registration of security-based swap dealers and major security-based swap participants		
• Business conduct standards for security-based swap dealers and major security-based swap participants	Proposed Rules (SEC, Release No. 34-64766) - Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants (comments period closed)	

• Capital requirements and margin requirements	Proposed Rules (OCC, Board of Governors of Federal Reserve System, FDIC, Farm Credit Administration, Federal Housing Finance Agency; Docket No. OCC-2011-0008) - Margin and Capital Requirements for Covered Swap Entities (comments period closed)	
• Rules governing duties of security-based swap dealers and major security-based swap participants		
• Rules governing daily trading records for security-based swap dealers and major security-based swap participants	Proposed Rule (SEC, Release No. 34-63727) - Trade Acknowledgment and Verification of Security-Based Swap Transactions (comments period closed)	
• Rules governing documentation standards for security-based swap dealers and major security-based swap participants		
Section 765 - Conflicts of Interest - Rules to improve governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a security-based swap dealer or major security-based swap participant's conduct of business with, a clearing agency, national securities exchange, or security-based swap execution facility that clears, posts, or makes available for trading security-based swaps and in which such security-based swap dealer or major security-based swap participant has a material debt or equity investment	Proposed Rule (SEC, Release No. 34-64018) - Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps under Regulation MC (comments period closed)	
Section 766 - Beneficial Ownership Reporting	Final Rule (SEC, Release No. 34-64628) - Beneficial Ownership Reporting Requirements and Security-Based Swaps	Effective Date: July 16, 2011
Section 766(a) - Reporting and Recordkeeping - Rules providing for reporting of each security-based swap entered into before the date of enactment of Dodd-Frank (June 21, 2010)	Interim Final Temporary Rule (SEC, Release No. 34-63094) - Reporting of Security-Based Swap Transaction Data	Effective Date: October 20, 2010 until January 12, 2012

Section	Status	Effective Date; Compliance Date(s)
Section 804 - Designation of Systemic Important Financial Market Utilities	Final Rule (Financial Stability Oversight Council, RIN 4030-AA01) - Authority to Designate Financial Market Utilities as Systemically Important	Effective Date: August 26, 2011
Section 805(a)(1) - Risk Management Standards for Systemically Important Financial Market Utilities and Payment, Clearing and Settlement Activities	Proposed Rule (Federal Reserve System, Docket No. R-1412) - Financial Market Utilities (comments period closed)	
	Notice of Proposed Rulemaking (CFTC, RIN 3038-AD98) - Financial Resources Requirements for Derivatives Clearing Organizations (comments period closed)	
Section 805(a)(2) - Special Procedures for Designated Clearing Entities and Designated Activities of Certain Financial Institutions	Proposed Rule (SEC, Release No. 34-64017) - Clearing Agency Standards for Operation and Governance (comments period closed)	
Section 806 - Operations of Designated Financial Market Utilities	Final Rule (CFTC, RIN 3038-AD07) - Provisions Common to Registered Entities	Effective Date: September 26, 2011
	Proposed Rule (Federal Reserve System, Docket No. R-1412) - Financial Market Utilities (comments period closed)	
	Proposed Rule (SEC, Release No. 34-63557) - Process for Submission for Review of Security-Based Swaps for Mandatory Clearing and Notice of Filing Requirements for Clearing Agencies (comments period closed)	
Section 806(b) - Limits, Restrictions and Regulations Regarding Discount and Borrowing Privileges That May Be Granted to Financial Market Utilities		
Section 806(e)(1)(B) - Notice to Supervisory Agency by Designated Financial Market Utility of Proposed Change to Rules, Procedures or Operations		
Section 809(b)(3) - Recordkeeping or Reporting Requirements For Designated Clearing Entities or Financial Institutions Engaged in Designated Activities		

Section 810 - Implementing regulations for Title VIII and rules to prevent evasions thereof		
Section 813 - Common Framework for Designating Clearing Entity Risk Management		

Section	Status	Effective Date; Compliance Date(s)
INCREASING INVESTOR PROTECTIONS	Advance Notice of Proposed Rulemaking (SEC, Release No. IC-29779) - Treatment of Asset-Backed Issuers under the Investment Company Act (comments due before November 7, 2011)	
Section 913(f) - Standards of Care and Conduct for Brokers, Dealers, Investment Advisers and Associated Persons	Temporary Final Rule (SEC, Release No. IA-3128) - Principal Trades with Certain Advisory Clients	Effective date: December 30, 2010 until December 31, 2012
Section 913(g) - Prohibitions on Certain Sales Practices, Conflicts of Interest, and Compensation Schemes for Brokers, Dealers, and Investment Advisers		
Section 916 - Streamlining of Filing Procedures for SRO's	Final rule (SEC, Release No. 34-63723) - Rules of Practice	Effective date: January 14, 2011
Section 919 - Rule Regarding Documents and Information to be Provided by a Broker or Dealer to Retail Investor	Proposed Rule (SEC, File No. SR-2011-018) - Proposed Rule Change to Adopt NASD Rule 2830 as FINRA Rule 2341 (Investment Company Securities) in the Consolidated FINRA Rulebook (comments period closed)	
INCREASING REGULATORY ENFORCEMENT AND REMEDIES		
Section 921(a) - Prohibition or Conditions/Limitations Use of Agreements That Require Clients of Broker, Dealer or Municipal Securities Dealer to Arbitrate Disputes Arising Under Federal Securities Laws		
Section 922(a) - Whistleblower Protection - Rules regarding whistleblowing and awards	Final Rule (SEC, Release No. 34-64545) - Securities Whistleblower Incentives and Protections	Effective date: August 12, 2011
Section 924 - Whistleblower Protection - Implementing amendments to Securities Act of 1933, Investment Company Act of 1940, Investment Advisers Act of 1940, Securities Exchange Act of 193		
Section 926 - Disqualifying Felons and Other "Bad Actors" From Regulation D Offerings	Proposed Rule (SEC, Release No. 33-9211) - Disqualification of Felons and Other "Bad Actors" from Rule 506 Offerings (comments period closed)	

Section 929Q(a) - Recordkeeping Requirements - Rules requiring each person having custody or use of securities, deposits, or credits of a registered investment company to maintain and preserve all records that relate to such custody or use		
Section 929R - Beneficial Ownership and Short-Swing Profit Reporting - Amendments to Section 13 of the Exchange Act requirements regarding beneficial ownership and short-swing profit reporting		
Section 929X(a) - Short Sale Reforms - Monthly public disclosure of name of issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security		
Section 929X(b) - Short Sale Reforms - Enforcement options and remedies for violations of short-selling regulations		
IMPROVEMENTS TO REGULATION OF CREDIT RATING AGENICES		
Section 932(a)(2)(B) - Annual Internal Controls Report to SEC	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(3)(A) - Internal Controls over Processes for Determining Credit Ratings - SEC to set out factors for NRSROs to consider in establishing policies, procedures and methodologies for determining credit ratings	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(4)(A) - Separation of Ratings from Sales and Marketing	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(8) - Establishment of Office of Credit Ratings within SEC		
Section 932(a)(8) - Penalties For Violations of Regulations Applicable to NRSROs	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(8) - Transparency of Rating Performance - Public disclosure by NRSROs of information regarding initial ratings and changes to those ratings	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(8) - Credit Rating Methodologies - SEC to prescribe rules with respect to procedures and methodologies used by NRSROs	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	

Section 932(a)(8) - Transparency of Credit Rating Methodologies and Information Reviewed - Rules regarding form and content of disclosure regarding credit ratings	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 932(a)(8) - Due Diligence Services for Asset-Backed Securities - Disclosure of third-party due diligence services employed by NRSROs	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 933 - State of Mind in Private Actions - Implementing regulations	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 936 - Qualification Standards for Credit Rating Analysts		
Section 938 - Universal Rating Symbols - Requirement for each NRSRO to establish, maintain and enforce policies sand procedures that access probability that an issuer will default or otherwise not make payments to investors, clearly define and disclose the meaning of any symbol used by such NRSRO, and apply such symbols consistently	Proposed Rules (SEC, Release No. 34-64514) - Nationally Recognized Statistical Rating Organizations (comments period closed)	
Section 939(A) - Review of Reliance on Ratings	Re-Proposed Rule (SEC Release Nos. 33-9244; 34-64968) - Re-Proposal of Shelf Eligibility Conditions for Asset-Backed Securities (comments period ends October 4, 2011)	
	Final Rule (SEC Release Nos. 33-9245; 34-64975) - Security Ratings	Effective date: September 2, 2011, except for certain amendments which are effective December 31, 2012
	Final Rule (CFTC RIN 3038-AD11) - Removing Any Reference to or Reliance on Credit Ratings in Commissions Regulations; Proposing Alternatives to the Use of Credit Ratings	Effective date: September 23, 2011
	Final and Temporary Regulations (IRS RIN 1545-BK28) - Modification of Treasury Regulations Pursuant to Section 939A of Dodd-Frank	Effective Date: July 6, 2011
	Proposed Rule (SEC Release No. 33-9193) - References to Credit Ratings in Certain Investment Company Act Rules and Forms (comments period closed)	

	Advance Notice of Proposed Rulemaking (Farm Credit Administration, RIN 3052-AC71) - Funding and Fiscal Affairs, Loan Policies and Operations, and Funding Operations; Capital Adequacy Risk-Weighting Revisions: Alternatives to Credit Ratings (comments due before November 25, 2011)	
	Proposed Rule (National Credit Union Administration, RIN 3133-AD95) - Corporate Credit Unions (comments due by October 6, 2011)	
Section 939B - Elimination of Exemption from Fair Disclosure Rule for disclosures made to NRSROs		
Section 939F(d) - System for Assignment of NRSROs to Determinate the Initial Credit Rating of Structured Finance Products		
Section 939G		
IMPROVEMENTS TO ASSET-BACKED SECURITIZATION PROCESS		
Section 941(b) - Credit Risk Retention Requirement for Asset-Backed Securities	Proposed Rule (OCC, Federal Reserve System, FDIC, Federal Housing Finance Agency, SEC, Department of Housing and Urban Development; SEC Release No. 34-64148) - Credit Risk Retention (comments period closed)	
Section 941(b) - Exemption of Qualified Residential Mortgages from Risk Retention Requirement and Other Discretionary Exemptions		
Section 941(b) - Establishment of Asset Classes with Separate Rules Regarding Risk Retention for Each Class		
Section 942(b) - Disclosure and Reporting for Asset-Backed Securities - Disclosure by issuers of asset-backed securities of asset-level or loan-level data	Final Rule (SEC Release No. 34-65148) - Suspension of the Duty to File Reports for Classes of Asset-Backed Securities Under Section 15(d) of the Securities Exchange Act of 1934	Effective Date: September 22, 2011
Section 943 - Use of Representations and Warranties in Asset-Backed Offerings	Final Rule (SEC Release Nos. 33-9175; 34-63741) - Disclosure for Asset-Backed Securities Required by Section 943 of Dodd-Frank	Effective Date: March 28, 2011; Compliance dates vary

Section 945 - Due Diligence Analysis and Disclosure in Asset-Backed Offerings	Final Rule (SEC Release Nos. 33-9176; 34-63742) - Issuer Review of Assets in Offerings of Asset-Backed Securities	Effective Date: March 38, 2011 Compliance Date: Any registered offering of asset-backed securities commencing with an initial bona fide offer after December 31, 2011
ACCOUNTABILITY AND EXECUTIVE COMPENSATION		
Section 951 - Shareholder Approval of Golden Parachute Compensation	Final Rule (SEC, Release No. 33-9178) - Shareholder Approval of Executive Compensation and Golden Parachute Compensation (comments period closed)	
	Advance Notice of Proposed Rulemaking (Farm Credit Administration, RIN 3052-AC41) - Standards of Conduct and Referral of Known or Suspected Criminal Violations; Disclosure to Shareholders (comments period closed)	
Section 952(a) - Independence of Compensation Committees - Requirement for each public company to have an independent compensation committee; independence standards; disclosure regarding compensation consultants	Proposed Rule (SEC, Release No. 33-9199) - Listing Standards for Compensation Committees (comments period closed)	
Section 953 - Executive Compensation Disclosure - Expanded disclosure requirements in any proxy or consent solicitation for an annual meeting of shareholders regarding executive compensation		
Section 954 - Recovery of Erroneously Awarded Compensation		
Section 955 - Disclosure Regarding Employee and Director Hedging		
Section 956(a) - Enhanced Incentive-Based Compensation Disclosure	Proposed Rule (OCC, Federal Reserve System, FDIC, OTC, National Credit Union Administration, Federal Housing Finance Agency, SEC, Release No. 34-64140) - Incentive-Based Compensation Arrangements (comments period closed)	

Section 956(b) - Prohibition on Certain Compensation Arrangements That Encourage Inappropriate Risks by Financial Institutions	Proposed Rule (OCC, Federal Reserve System, FDIC, OTC, National Credit Union Administration, Federal Housing Finance Agency, SEC, Release No. 34-64140) - Incentive-Based Compensation Arrangements (comments period closed)	
Section 957 - Proxy Voting by Brokers		
STRENGTHENING CORPORATE GOVERNANCE		
Section 971 - Rules Permitting Use by a Shareholder of Proxy Solicitation Materials Supplied by an Issuer for Purpose of Nominating Directors	Final Rule (SEC, Release No. 33-9136) - Facilitating Shareholder Director Nominations **(D.C. circuit vacated this Final Rule on July 22, 2011 in *Business Roundtable and Chamber of Commerce of the United States of America v. SEC,* No. 10-1305)**	Effective Date: November 15, 2010; Compliance Date: November 15, 2010 for all companies except with respect to "smaller reporting companies" the compliance date is November 15, 2013
Section 972 - Disclosure in Annual Proxy Regarding Chairman and CEO Structures		
Section 975 - Regulation of Municipal Securities and Changes to the Board of MSRB	Interim Final Temporary Rule (SEC Release No. 34-62824) - Temporary Registration of Municipal Advisors	Effective Date: October 1, 2010 through December 31, 2011
	Proposed Rule (SEC, Release No. 34-63576) - Registration of Municipal Advisors (comments period closed)	

	Proposed Rule (SEC, Release No. 34-65234) -Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule Change by the Municipal Securities Rulemaking Board Consisting of Amendments to MSRB Rule G-20 (Gifts and Gratuities) and Related Amendments to MSRB Rule G-8 (Books and Records) and MSRB Rule G-9 (Preservation of Records), and to Clarify That Certain Interpretations by the Financial Industry Regulatory Authority and the National Association of Securities Dealers Would Be Applicable to Municipal Advisors (comments period closed)	
	Final Rule Amendments (SEC, Release Nos. 33-9256; 34-65244; 39-2478; IC-29780) - Amendments to Include New Applicant Types on Form ID	Effective Date: date of publication of rule in Federal Register (to be determined)
	Proposed Rule (SEC, Release No. 34-65255) - MSRB; Notice of Filing of Proposed New Rule G-42, on Political Contributions and Prohibitions on Municipal Advisory Activities; Proposed Amendments to Rules G-8, on Books and Records, G-9, on Preservation of Records, and G-37, on Political Contributions and Prohibitions on Municipal Securities Business; Proposed Form G-37/G-42 and Form G-37x/G-42x; and a Proposed Restatement of a Rule G-37 Interpretive Notice	
PUBLIC COMPANY ACCOUNTING OVERSIGHT BOARD, PORTFOLIO MARGINING AND OTHER MATTERS		
Section 982 - Oversight of Brokers and Dealers	Proposed Rule (SEC, Release No. 34-64676) - Broker-Dealer Reports (comments period closed)	
	Temporary Rule for Interim Program of Inspection Related to Audits of Brokers and Dealers (PCAOB Release No. 2011-001)	
Section 984(a) - Prohibitions on and Regulation of Borrowing of Securities		
Section 984(b) - Increased Transparency of Information Available to Brokers, Dealers and Investors Regarding Loan or Borrowing of Securities		

HERRICK, FEINSTEIN LLP'S
FIFTH ANNUAL CAPITAL MARKETS SYMPOSIUM
SEPTEMBER 22, 2011

ADDENDUM TO

ASSET-BACKED SECURITIZATION AND CREDIT RATING AGENCIES

BY PATRICK D. SWEENEY & JULIE ALBINSKY
HERRICK, FEINSTEIN LLP

ADDENDUM TO

ASSET-BACKED SECURITIZATION AND CREDIT RATING AGENCIES

The article included in the Capital Markets Symposium book – "Asset-Backed Securitization and Credit Rating Agencies" is current as of September 7, 2011.

On September 19, 2011, the SEC proposed a comprehensive set of rules to implement the Dodd-Frank directive regarding conflicts of interest which may arise between ABS sponsors and other "securitization participants", on the one hand, and ABS investors.

The proposed rules would prohibit "securitization participants" – ABS underwriters, placement agents, initial purchasers, sponsors and possibly collateral managers – from engaging in transactions involving a "material conflict of interest" at any time for a period ending on the date that is one year after the date of the first closing of the sale of the ABS. The starting point for this time period is not specified in the proposed rules. The rules would apply to both public and private ABSs, including synthetic ABSs.

The conflicts of interest targeted by the SEC include transactions in which a securitization participant effects a short sale of, or purchases CDS (credit default swap) protection on, the ABS securities or the underlying financial assets. Transactions would also include the selection of assets for the ABS's underlying pool and the sale of those assets to the ABS issuer. "Material conflicts of interest", which would be prohibited, are those in which the securitization participant benefits from the adverse performance of the asset pool, losses on the ABSs, or declines in the market value of the ABSs.

"Material conflicts of interest" would also include situations in which the securitization participant receives remuneration from a third party who is permitted by the securitization participant to structure the ABS transaction, or to select financial assets for the ABS transaction, in way which permits the third party to benefit from a short transaction. In all of the foregoing cases, there must be a "substantial likelihood" that a "reasonable" investor would consider the conflict important to his or her investment decision.

As demonstrated by the examples provided by the SEC in its proposal release, the potential scope of the conflict of interest rules is quite broad. In some cases, the rules would prohibit a sponsoring bank from providing the CDS product which is essential to the formation of a synthetic ABS.

The SEC has solicited numerous comments on its proposed rules, and has set a deadline of December 19, 2011 for receipt of comments. Voluminous comments from the securitization industry should be expected.

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Asset-Based Lending
Bank Regulatory
Business Divorce
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Corporate Real Estate and REITs
Corporate Restructuring and Disposition
Entrepreneurship
Franchising
Health Care
Hedge Funds
Inbound Investment/International
Independent Private Equity Sponsors
Institutional Lending
Investment Management
Leveraged Buyouts
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New Markets Tax Credits
Private Equity
Registered Investment Companies
Securities
Tax-Exempt Organizations
Venture Capital/Emerging Growth

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Corporate Compliance
Employee Benefits and Executive Compensation
Employment Litigation
ERISA Litigation
Risk Management Services

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INSURANCE & REINSURANCE

Insurance Coverage Litigation
Reinsurance Disputes
Transactional/Regulatory

INTELLECTUAL PROPERTY

Litigation and Enforcement
Transactional

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Alternative Dispute Resolution
Business Divorce
Class Actions
Commercial Litigation
Construction Litigation
Distressed Debt
Product Liability
Real Estate Litigation
Records Retention
Securities and Commodities Litigation and Regulatory
Title Insurance
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Hospitality
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Joint Ventures - Public and Private
Land Use & Environmental
Leasing
Real Estate Loan Workouts, Restructuring & Foreclosures
Real Estate Finance
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NEW YORK
2 PARK AVENUE
NEW YORK, NY 10016
T 212.592.1400
F 212.592.1500

NEWARK
ONE GATEWAY CENTER
NEWARK, NJ 07102
T 973.274.2000
F 973.274.2500

PRINCETON
210 CARNEGIE CENTER
PRINCETON, NJ 08540
T 609.452.3800
F 609.520.9095

>> WWW.HERRICK.COM

HERRICK

NEW YORK
2 PARK AVENUE
NEW YORK, NY 10016
T 212.592.1400
F 212.592.1500

NEWARK
ONE GATEWAY CENTER
NEWARK, NJ 07102
T 973.274.2000
F 973.274.2500

PRINCETON
210 CARNEGIE CENTER
PRINCETON, NJ 08540
T 609.452.3800
F 609.520.9095

>> WWW.HERRICK.COM