TITLE IX: Investor Protections and Improvements to the Regulation of Securities

Title IX of the Act, the "Investor Protection and Securities Reform Act of 2010" (the "IPSRA"), covers a broad array of issues affecting securities markets participants, including the standard of conduct for broker-dealers and investment advisers, whistle blower and expanded liability provisions, compliance requirements for nationally recognized statistical rating organizations ("NRSROs"), executive compensation, and corporate governance.

A. Increasing Investor Protection

1. Investor Advisory Committee

The Act establishes an Investor Advisory Committee (the "IAC") with responsibility for advising and consulting with the SEC on the agency's regulatory priorities, issues relating to the regulation of securities products, trading strategies, fee structures, and the effectiveness of disclosure, and initiatives to protect investor interests and to promote investor confidence and the integrity of the securities markets. The IAC's 10-20 members must include an Investor Advocate and representatives of each of (a) the state securities commissions, (b) senior citizens, (c) individual equity and debt investors, and (d) institutional investors. **Sec. 911 (pp. 455-456)**.

2. Office of the Investor Advocate

The Act amends Section 4 of the Exchange Act to establish the Office of the Investor Advocate, the head of which reports directly to and is appointed by the SEC's Chairman, in consultation with the SEC, but who may not have worked for the SEC during the prior two years. Among other things, the Investor Advocate, who is authorized to retain or employ independent counsel and research and service staff, is responsible for assisting retail investors in resolving significant problems that they may have with the SEC or SROs, identifying areas in which investors would benefit from changes in SEC or SRO rules, identifying problems that investors may have with financial service providers and investment products, and analyzing the potential impact on investors of SEC and SRO rulemaking. The Investor Advocate must prepare an annual report to the Congressional Banking Committees on a variety of activities related to its objectives, and propose to the SEC changes to its regulations or orders, and to Congress any legislative, administrative, or personnel changes that may be appropriate to mitigate any identified problems and to promote investors' interests. Under, new paragraph (g)(5) of Section 4 of the Exchange Act, the Investor Advocate would be given *full access* to the documents of the SEC and any SRO as necessary to carry out its functions. It is unclear how this provision would apply to documents for which protection is sought under FOIA. **Sec. 915 (pp. 464-466)**.

Within 180 days of appointment, the Investor Advocate must, pursuant to Section 4(g) of the Exchange Act, appoint an Ombudsman to act as a liaison between the SEC and retail investors and to protect the confidentiality of information provided to the Investor Advocate. **Sec. 919D (p. 474)**.

3. Investor Testing

The Act amends Section 19 of the 1933 Act to allow the SEC to gather information from

and consult with members of the public, including investors, academics and consultants in connection with considering or conducting rulemaking. The Act also authorizes the SEC to engage in temporary investor testing programs. **Sec. 912 (pp. 457-458)**.

4. Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers (The "Fiduciary Duty" Provision)

Within six months of enactment, the Act directs the SEC to conduct a study to evaluate the effectiveness of and gaps or overlaps that should be addressed by rule or statute in the existing legal and regulatory standards of care for brokers, dealers, investments advisers and their associated persons when providing personalized investment advice and recommendations about securities to their respective "retail customers." A "retail customer" is defined as a natural person, or his or her legal representative, who (i) receives personalized investment advice about securities from a broker, dealer, or investment adviser, and (ii) uses such advice primarily for personal, family, or household purposes. **Sec. 913 (pp. 458, 461)**.

5. Study Considerations

In completing its study, the Act directs the SEC to consider the following items:

i. The effectiveness of existing legal and regulatory standards of care for brokers, dealers, investments advisers, and their associated persons;

ii. Any gaps, shortcomings, or overlaps in legal or regulatory standards of care relating to such persons;

iii. Retail customer understanding of differences in standards of care applicable to such persons;

iv. Any retail customer confusion related to differing standards of care and the quality of advice that they receive;

v. The regulatory, examination, and enforcement resources devoted to, and the activities of, the SEC, the states, and a national securities association to enforce the standards of care applicable to broker-dealers, investments advisers, and their respective associated persons, including the frequency, length of time, and effectiveness of such examinations in determining compliance with regulations;

vi. The substantive differences in the regulation of brokers, dealers, and investment advisers when providing personalized investment advice and recommendations about securities to retail customers;

vii. The specific instances in which regulation and oversight of investment advisers provide greater protection to retail customers than the regulation of brokers and dealers and those instances in

which regulation and oversight of brokers and dealers provide greater protection to retail customers than the regulation of investment advisers;

viii. The existing legal or regulatory standards of state securities regulators and other regulators intended to protect retail customers;

ix. The potential impact on retail customers and their access to products and services of imposing on brokers, dealers, and associated persons the standards of care and other requirements applied under the Advisers Act;

x. The potential benefits and harm to retail customers, number of and additional costs to entities and individuals that would become subject to the Advisers Act, and the potential impact onto the SEC and the states, if the broker exception is eliminated from the definition of "investment adviser" in the Advisers Act;

xi. The varying level of services provided to retail customers by and the varying scope and terms of retail customer relationships with brokers, dealers, investment advisers, and their associated persons;

xii. The potential impact upon retail customers that may result from potential changes in the regulatory requirements or standards of care affecting brokers, dealers, investments advisers and their associated persons, including any potential impact on protection from fraud, and access to and the availability of personalized investment advice and recommendations about securities;

xiii. The potential added costs and expenses, including the potential impact on the profitability of their investment decisions, to retail customers, brokers, dealers, and investment advisers resulting from changes to the duty of care; and

xiv. Any other consideration the SEC considers necessary and appropriate in determining whether to conduct a rulemaking. **Sec. 913 (pp. 458-461).**

6. Report & Rulemaking

Six months after enactment of the Act, the SEC must report to the Congressional Banking Committees on any identified legal or regulatory gaps, shortcomings or overlap in legal or regulatory standards for protecting retail customers relating to the standard of care of brokers, dealers, investment advisers and their associated persons. The SEC is required to seek public comment in order to prepare its report. In consideration of the findings, conclusions, and recommendations of its report, the Act allows the SEC to commence rulemaking to address the legal or regulatory standards of care for brokers, dealers, investment advisers, and associated persons. **Sec. 913(d)-(f) (p. 461)**.

New Exchange Act Section 15 (k) grants the SEC the explicit authority to promulgate rules applying the standard of care applicable to investment advisers under Section 211 of the Advisers Act to brokers and dealers when providing personalized investment advice about securities to retail customers or such other customers as the SEC specifies by rule. The Act specifies that the receipt of commissions or other standard compensation for the sale of securities will not in and of itself be considered a violation of the standard of care by a broker or dealer. Additionally, brokers and dealers will have no continuing duty of care or loyalty to a customer after providing personalized investment advice about securities. Although a broker or dealer's sale of only proprietary or other limited range of products will not, in and or itself, be considered a violation of any applicable standard of care, the SEC may, by rule, require that the broker or dealer provide notice to each retail customer and obtain the customer's consent or acknowledgement. **Sec. 913(g) (pp. 461-462)**.

The SEC is required to facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers and investment advisers, including any material conflicts of interest. The Act also instructs the SEC to examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes that the SEC deems contrary to public interest and protection of investors. **Sec. 913(g) (pp. 462-463)**.

New Section 211(g) of the Advisers Act authorizes the SEC to promulgate rules to provide that when a broker, dealer, or investment adviser provides personalized investment advice about securities to a retail customer or such other customers as the SEC may provide, such broker, dealer, or investment adviser must act in the best interest of the customer without regard to the financial or other interests of the broker, dealer, or investment adviser. In accordance with such rules, material conflicts of interest may be disclosed and consented to by the customer. Such standard of conduct must be no less stringent than the standard applicable to investment advisers under Sections 206(1) and (2) of the Advisers Act. The SEC may not define "customer" to include an investor in a private fund managed by an investment adviser where the private fund has entered into an advisory contract with the adviser, and the receipt of compensation based on commission or fees will not, in and of itself, be considered a violation of the standard of care by a broker, dealer, or investment adviser. **Sec. 913(g) (pp. 462-463)**.

7. Harmonization of Enforcement

The Act also instructs the SEC to harmonize enforcement with respect to violations of the Exchange Act by broker-dealers and the Advisers Act by investment advisers with respect to the standard of care applicable to such broker-dealers or advisers providing personalized investment advice to retail customers. **Sec. 913(h) (p. 463-464)**.

8. Investor Disclosure Before Purchase of Investment Products and Services

New Exchange Act Section 15(n) authorizes the SEC to issue rules designating documents or information that broker-dealers must provide to retail investors before they purchase an investment product or service. Any required disclosures will need to be in a summary format and include clear and concise information about investment objectives, strategies, costs, and risks and any compensation or other financial incentive received by a

broker, dealer, or other intermediary in connection with the purchase of retail investment products. **Sec. 919 (p. 471)**.

9. Streamlining of SRO Rule Filing Process

The SRO rule filing process will be streamlined by requiring the SEC, within 45 days of a proposed rule change being published in the Federal Register, to approve or disapprove of such proposed rule change or to initiate proceedings to determine if the proposed rule change should be disapproved. This initial 45-day time frame maybe extended by the SEC if the SEC published reasons as to why such extension is appropriate or the SRO consents to the longer time frame. If proceedings are initiated, the SRO is to be given an opportunity for notice and a hearing that is to be conducted within 180 days of publication of the original proposed rule change. Generally a final determination should be made on any rule within this 180-day period. **Sec. 916 (pp. 466-470)**.

10. Additional Studies

The Act requires the SEC and the Comptroller General to conduct other studies regarding investment adviser examination, financial literacy, mutual fund advertising, conflicts of interest, investor access to information on investment advisers and broker-dealers, and financial planners and the use of financial designations. The reports on these studies would be due to the Congressional Banking Committees as described below.

11. Investment Adviser Examinations

The Act requires the SEC to review the need for enhanced examination and enforcement resources for investment advisers, including the number and frequency of examinations for investment advisers, the need for an SRO for investment advisers, and approaches for examining dually registered or affiliated broker-dealers and investment advisers. The SEC must within 180 days of enactment of the IPSRA, submit a report to the Congressional Banking Committees on its findings, and use its findings to form the basis for revising any rules and regulations, as necessary, as well as recommendations for any legislative or regulatory steps that may be necessary to address any identified concerns. **Sec. 914 (p. 464)**.

12. Financial Literacy Among Investors

The SEC is required to study, and to submit a report to the Congressional Banking Committees within two years of enactment of the Act, on: (i) the existing level of financial literacy among retail investors and subgroups thereof; (ii) methods to improve the timing, content, and format of disclosures to investors with respect to financial intermediaries, investment products, and investment services; (iii) the most useful and understandable relevant information that retail investors need to make informed financial decisions before engaging a financial intermediary or purchasing an investment product or service that is typically sold to retail investors, including shares of mutual funds; (iv) methods to increase the transparency of expenses and conflicts of interests in transactions involving investment services and products, including shares of mutual funds; (v) the most effective existing private and public efforts to educate investors; and (vi) in consultation with the Financial Literacy and Education Commission, a strategy to increase the financial literacy of investors. **Sec. 917 (p. 470)**.

13. Mutual Fund Advertising

The Comptroller is required to conduct a study, and to report to the Congressional Banking Committees within 18 months after enactment of the Act, on mutual fund advertising to identify: (i) existing and proposed regulatory requirements for open-end investment company advertisements; (ii) current marketing practices for the sale of open-end investment company shares, including the use of past performance data, funds that have merged, and incubator funds; (iii) the impact of such advertising on consumers; and (iv) recommendations to improve investor protections in mutual fund advertising and additional information necessary to ensure that investors can make informed financial decisions when purchasing shares. **Sec. 918 (pp. 470-471)**.

14. Conflicts of Interest

The Comptroller is required to conduct a study, and to report to the Congressional Banking Committees within 18 months of enactment of the Act, to identify and examine potential conflicts of interest that exist between the staffs of the investment banking and equity and fixed income securities analyst functions within the same firm, and to make recommendations to Congress designed to protect investors from such conflicts. Among other things, the Comptroller is directed to consider the nature and benefits of the undertakings entered into by investment banks subject to the global research settlement, such as firewalls between research and investment banking, disclosures, limitations on soliciting investment banking business, and to recommend whether any such undertakings should be codified. **Sec. 919A (pp. 471-472)**.

15. Improved Investor Access to Information on Investment Advisers and Broker-Dealers

Within six months of enactment of the Act, the SEC is required to complete a study, including recommendations, to improve investor access to registration information (including disciplinary actions, regulatory, judicial, and arbitration proceedings) about current and previously registered brokers, dealers, investment advisers and their associated persons on the existing Central Registration Depository and Investment Adviser Registration Depository systems. Within 18 months of the completion of the study, the SEC must implement any recommendations from the study. **Sec. 919B (p. 472)**.

16. Financial Planners and the Use of Financial Designations

Within 180 days of the enactment of the Act, the Comptroller is required to conduct a study on the effectiveness of state and federal regulations to protect investors and other consumers from individuals holding themselves out as financial planners through the use of misleading titles, designations, or market materials, the current state and federal oversight structure and regulation for financial planners, the ability of investors to understand such designations, and any legal or regulatory gaps in the regulation of financial planners and other individuals who provide or offer to provide financial planning services to consumers. The study report would need to include recommendations for the appropriate regulation of financial planners and other individuals who provide similar services with respect to the sale of insurance

and securities. **Sec. 919C (pp. 472-474)**.

Until the SEC promulgates rules to address the fiduciary duty and disclosure issues, the impact for broker-dealers and investment advisers when dealing with their customers and clients cannot be determined. A detailed analysis of these provisions can be found in our alert on *The Dodd-Frank Wall Street Reform and Consumer Protection Act (H.R. 4173) from the Broker-Dealer's Perspective*, available at http://www.gibsondunn.com/Publications/Pages/Dodd-FrankHR4173FromBroker-DealerPerspective.aspx.

B. Increasing Regulatory Enforcement and Remedies

1. Mandatory Pre-Dispute Arbitration Provisions

The Act amends Section 15 of the Exchange Act to provide that the SEC, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of brokers, dealers or municipal securities dealers to arbitrate future disputes between them arising under the securities laws. The Act makes a parallel amendment to Section 205 of the Advisers Act that provides that the SEC, by rule, may prohibit, or impose conditions or limitations on the use of, agreements that require customers or clients of investment advisers to arbitrate future disputes between them arising under the securities laws. **Sec. 921 (pp. 474-475).**

2. Rewards to and Protections of Whistleblowers

a. Rewards to Whistleblowers

The Act amends the Exchange Act by adding new Section 21F. Section 21F provides that a whistleblower who voluntarily provides information to the SEC that leads to a successful enforcement action resulting in over $1,000,000 of monetary sanctions <u>must</u> be awarded by the SEC an amount not less than 10% and not more than 30% of the monetary sanctions collected. The Act states that determination of the amount of the award shall be in the discretion of the SEC, taking into consideration the significance of the information provided, the degree of assistance provided, the programmatic interest of the SEC in deterring violations of the securities laws by rewarding whistleblowers and other factors the SEC may establish. **Sec. 922(a) (pp. 475-477).**

Under the Act, a "whistleblower" is any individual who provides, or two or more individuals acting jointly who provide, original information relating to a violation of the securities laws to the SEC derived from the individual or individuals' own independent knowledge or analysis, not previously known to the SEC from another source, and not exclusively derived from external, publicly available information. The Act prohibits awards paid to various whistleblowers, including, but not limited to, people who work for certain regulatory or law enforcement entities, people who obtain information through performance of a financial audit required by the securities laws or people who are convicted of a crime related to the action for which the information was provided. While the Act gives the SEC discretion to determine to whom or in what amount an award should be made, it does not expressly prohibit persons who are complicit in the alleged violation from collecting an award. **Sec. 922 (p. 477).**

The Act provides that a whistleblower who makes a claim for an award is always

permitted to be represented by counsel and must be represented by counsel if the claim is made anonymously and is based on information anonymously provided. The Act allows a whistleblower to appeal a determination regarding an award, unless the determination relates to the amount of an award when the award is made in accordance with provisions of the Act. **Sec. 922 (pp. 477-478).**

The Act requires that a Securities and Exchange Commission Investor Protection Fund be established by the Treasury of the United States out of which whistleblower awards will be paid. The Act contains various provisions with respect to deposits and credits and the manner in which money in the fund can be invested. Under the Act, the fund would be capped at $300,000,000. Money in the fund can also be used to fund certain activities of the Inspector General of the SEC. **Sec. 922(g) (pp. 478-479).**

b. Whistleblower Protections

The Act creates new whistleblower protections for employees who provide information to or assist the SEC, authorizing a new private right of action for reinstatement, two times back pay, and other relief. This new cause of action can be brought in a federal district court within 6 years of a violation or 3 years of discovery, but in no event later than 10 years after a violation. **Sec. 922(a) (pp. 479-480).**

The Act also expands the coverage of the existing whistleblower protections given by the Sarbanes Oxley Act of 2002 (15 U.S.C. § 7211) ("SOX") by expressly including employees of subsidiaries of publicly traded companies included in their parent corporation's consolidated financial statements, extending the statute of limitations from 90 to 180 days, prohibiting mandatory predispute arbitration agreements for SOX claims, and clarifying the right to a jury trial. **Sec. 922(c) (p. 482).**

Under the Act, all information provided to the SEC by a whistleblower is confidential and privileged, although disclosure may be made to certain government agencies if such disclosure is necessary to enable other regulatory entities to accomplish the purposes of the Exchange Act. **Sec. 922 (pp. 480-481).**

The Act requires the SEC to establish an office to administer and enforce the whistleblower incentives and protection provisions explained above. This office will report annually to the Senate Banking Committee and the House Financial Services Committee on its activities, whistleblower complaints, and the SEC's response to such complaints. Under the Act, the SEC is required to issue final regulations implementing the provisions described above within 270 days of enactment. **Sec. 924 (p. 484).**

The Act also makes various conforming amendments to the securities laws related to the funding of the Securities and Exchange Commission Investor Protection Fund. **Sec. 923 (pp. 483-484).**

As a result of the incentives of the whistleblower award program, registrants, brokerage firms, and investment advisers may see an immediate increase in the number, volume and size of whistleblower complaints made to the SEC regarding their businesses. While the legislation does not create a *qui tam* right of action analogous to that contained in the False Claims Act, it

provides a powerful financial incentive for persons to make claims of wrongdoing in light of the potentially significant rewards when the SEC obtains a large dollar civil money penalty. The whistleblower protections build on the SEC's enforcement cooperation initiative, which permits the SEC and its staff to assure a cooperating individual that he or she will not be charged with a violation or will receive reduced sanctions in exchange for information leading to enforcement action against others and facilitates the process of receiving testimonial use immunity from the Department of Justice. In light of the new cause of action for retaliation against a whistleblower and the associated relief of two times the amount of back pay otherwise owed, the policies companies have in place for responding to whistleblowers assume even greater importance.

3. Collateral Bars

The Act expands the SEC's enforcement authority by giving it the authority, after notice and a hearing and upon a determination that a person violated a federal securities law, to bar that person from associating with a range of SEC-regulated entities, and not just entities regulated by the specific title that was violated. Specifically, Sections 15(b)(6)(A), 15B(c)(4), and 17A(c)(4)(C) of the Exchange Act and Section 203(f) of the Advisers Act, which permit the SEC to bar a violator from association with a "broker or dealer", "municipal securities dealer", "transfer agent" or "investment adviser", respectively, are amended to allow the SEC to bar association with a "broker, dealer, investment adviser, municipal securities dealer, transfer agent, municipal adviser, or nationally recognized statistical rating organization" in each case. **Sec. 925 (pp. 484-485).**

4. Disqualifying Felons and Other "Bad Actors" From Regulation D Offerings

The Act requires that the SEC, within one year of enactment of the Act, issue rules for the disqualification of offerings and sales of securities made under Rule 506 of Regulation D of the Securities Act that disqualify any offer or sale of securities by certain felons and other "bad actors". **Sec. 926 (p. 485).**

Specifically, the SEC's rules must include disqualification provisions substantially similar to those found in Rule 262 of Regulation A of the Securities Act. Rule 262 disqualifies offers or sales by issuers; directors, officers, general partners and ten percent owners of issuers; and underwriters who have been convicted of certain offenses, enjoined by a court of certain securities-related misconduct involving false filings or who are subject to a suspension or bar from association with a securities brokerage firm or investment adviser by the SEC or a national securities exchange or association. The rules must also disqualify any offering or sale of securities by a person that is subject to a final order of a state securities, banking, insurance or similar regulator; a Federal banking agency, or the National Credit Union Administration, that (i) bars the person from (a) association with an entity regulated by such regulator; (b) engaging in the business of securities, insurance, or banking; or (c) engaging in savings association or credit union activities; or (ii) constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale. The rules must disqualify any offering or sale of securities by a person convicted of a felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the SEC. **Sec. 926 (p. 485).**

5. Equal Treatment of SRO Rules

The Act amends Section 29(a) of the Exchange Act, which prohibits contract provisions "binding any person to waive compliance with any provision of the Exchange Act or of any rule or regulation thereunder, or of any rule of an exchange," by substituting "rule of a self-regulatory organization" for "rule of an exchange required thereby." **Sec. 927 (p. 485); Sec. 929T (p. 501).**

6. Clarification that Section 205 of the Advisers Act Does Not Apply to State-Registered Advisers

The Act amends Section 205(a) of the Advisers Act, which imposes restrictions on the types of contracts into which investment advisers are permitted to enter, to clarify that it only applies to investment advisers registered or required to be registered with the SEC. As a result, Section 205(a) does not apply to state-registered advisers. **Sec. 928 (p. 486).**

7. Unlawful Margin Lending

The Act amends Section 7(c)(1)(A) of the Exchange Act, which makes it unlawful for any member of a national securities exchange or any broker or dealer to extend or maintain credit to or for any customer (i) on any security in contravention of the rules or regulation provided by the Fed, and (ii) without collateral, except in accordance with rules or regulations prescribed by the Fed. The Act replaces the word "and" between the two numbered clauses above with the word "or"; a substitution which has the effect of prohibiting margin lending if either of the conditions is met. **Sec. 929 (p. 486).**

8. Fair Fund Amendments

The Act amends Section 308 SOX, which provides that civil penalties obtained from a person who violates the securities laws should be added to a disgorgement fund for the benefit of the victims only if disgorgement is also required, to say that, on motion or at the direction of the SEC, civil penalties should be added to disgorgement or other funds established for the benefit of victims, regardless of whether disgorgement is also required. **Sec. 929B (p. 486).**

9. Nationwide Service of Subpoenas

The Act inserts identical provisions into the Securities Act, the Exchange Act, the Investment Company Act of 1940 ("ICA") and the Advisers Act. These provisions provide that in any action or proceeding instituted by the SEC under the respective titles in any United States district court, a subpoena issued to compel the attendance of a witness or the production of documents or things may be served at any place within the United States. The Act also provides that Rule 45(c)(3)(A)(ii) of the Federal Rules of Civil Procedure, which requires a court to quash or modify a subpoena that requires a non-party to travel more than 100 miles from where that person resides, does not apply to such subpoenas. **Sec. 929E (p. 487).**

10. Formerly Associated Persons

The Act amends numerous provisions of the Exchange Act, SOX, and the ICA to provide that the investigative and enforcement authority of the SEC and the Public Company Accounting

Oversight Board ("PCAOB") extends not only to persons currently associated with various regulated entities, but also to persons formerly associated with such entities, if the misconduct alleged occurred while the person was so associated. **Sec. 929F (pp. 487-489).**

11. SIPC Reforms

The Act amends Section 9 of the Securities Investor Protection Act of 1970 ("SIPA") by replacing the $100,000 per customer limit on cash advances from the Securities Investor Protection Corporation ("SIPC") with a limit of $250,000 per customer, to be adjusted for inflation by the Board of Directors of the SIPC, subject to approval of the SEC, no later than January 1, 2011 and every five years thereafter. **Sec. 292H (pp. 490-491).**

The Act also amends Section 5(a)(3) of the SIPA by specifying that no member of SIPC that has a customer may enter into an insolvency, receivership, or bankruptcy proceeding, under Federal or State law, without the specific consent of SIPC, except as provided in title II of the Investor Protection and Securities Reform Act of 2010. Title II sets forth provisions related to orderly liquidation. **Sec. 292H (p. 491).**

12. Protecting Confidentiality of Materials Submitted to the SEC

The Act amends the Exchange Act, the ICA and the Advisers Act to provide that the SEC must not be compelled to disclose records and information submitted to the SEC pursuant to the examinations provisions of those acts. The Act also includes provisions that have the effect of exempting such records and information from the provisions of the Freedom of Information Act (5 U.S.C. § 552) and exempting the collection of such records and information from Subchapter I of Title 44 of the United States Code, which deals with Federal Information Policy. **Sec. 929I (pp. 491-493).** These provisions substantially increase the confidentiality of information provided by brokerage firms and investment advisers in connection with data provided in SEC examinations.

13. Sharing of Privileged Information with Other Authorities

The Act amends Section 24 of the Exchange Act to provide that the SEC does not waive any privilege applicable to information by transferring it to or permitting it to be used by any agency, the PCAOB, any self-regulatory organization, any foreign securities or law enforcement authority, or any state securities or law enforcement authority. The amendment also provides that the SEC cannot be compelled to disclose privileged information obtained from a foreign securities or law enforcement authority if the authority has in good faith determined and represented to the SEC that the information is privileged. The amendment also provides that Federal agencies, the PCAOB, self-regulatory organizations, and state securities and law enforcement authorities do not waive any privilege applicable to information by transferring it to or permitting it to be used by the SEC (unless the information was obtained from a self-regulatory organization or the PCAOB and is being used by the SEC in an action against such organization). **Sec. 929K (pp. 494-495).**

These provisions are designed to enhance the ability of the SEC and the PCAOB to obtain information from overseas regulators. Many such regulators, particularly in the European Union, have declined to provide confidential data to the SEC and the PCAOB because of their

view that US law did not have adequate safeguards against the dissemination of private information.

14. Enhanced Application of Antifraud Provisions

The Act enhances the application of Section 9 of the Exchange Act, which prohibits manipulation of securities prices subject to certain conditions, (i) by removing the requirement that the security be registered on a national exchange and replacing it with a requirement that the security simply not be a government security; (ii) by removing the condition in subsection (b) that the action be done by use of a facility of a national securities exchange; and (iii) by expanding the reach of subsection (c) to include brokers and dealers in addition to members of a national securities exchange. **Sec. 929L (p. 495).**

The Act also expands the reach of Section 10(a)(1) of the Exchange Act, which makes it unlawful to effect a short sale or to use a stop-loss order in connection with the purchase or sale of any security on a national securities exchange in contravention of SEC rules, by removing the requirement that the security be registered on a national exchange and replacing it with a requirement that the security simply not be a government security. **Sec. 929L (p. 495).**

The Act also enhances the application of Section 15(c)(1)(A) of the Exchange Act, which prohibits a broker or dealer from effecting any transaction in any security otherwise than on a national securities exchange of which the broker or dealer is a member, by eliminating the requirement that the security be "otherwise than on a national securities exchange of which the broker or dealer is a member." **Sec. 929L (p. 495).**

15. Aiding and Abetting Authority Under the Securities Act and the Investment Company Act

The Act expands the SEC's enforcement authority by adding a new provision to Section 15 of the Securities Act which provides that, for purposes of any action brought by the SEC under subsections (b) or (d) of Section 20 of the Securities Act (relating to actions for injunction or criminal prosecution in district court, and money penalties in civil actions, respectively), any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of the Securities Act or the rules or regulations issued thereunder must be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided. **Sec. 929M (pp. 495-496).**

The Act also expands the SEC's enforcement authority by adding a new provision to Section 48 of the ICA which provides that, for purposes of any action brought by the SEC under subsections (d) or (e) of Section 42 of the ICA (relating to injunctions and money penalties in civil actions, respectively), any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of the ICA or the rules or regulations issued thereunder must be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided. **Sec. 929M (p. 496).**

16. Authority to Impose Penalties for Aiding and Abetting Violations of the Investment Advisers Act

The Act expands the SEC's enforcement authority by adding a new provision to Section 209 of the Advisers Act which provides that, for purposes of an action brought by the SEC under Section 209(e) of the Advisers Act (which relates to money penalties in civil actions), any person that knowingly or recklessly has aided, abetted, counseled, commanded, induced, or procured a violation of any provision of the Advisers Act or the rules, regulation, or orders thereunder, must be deemed to be in violation of such provision, rule, regulation, or order to the same extent as the person that committed such violation. **Sec. 929N (p. 496).**

17. Aiding and Abetting Standard of Knowledge Satisfied by Recklessness

The Act further expands the enforcement authority of the SEC by amending Section 20(e) of the Exchange Act to state that the standard of knowledge applicable to aiding and abetting violations of the Exchange Act is satisfied by recklessness. **Sec. 929O (p. 496).**

18. Strengthening Enforcement by the SEC

a. Authority to Impose Civil Penalties in Cease and Desist Proceedings

The Act makes amendments to the Securities Act, the Exchange Act, the ICA and the Advisers Act that authorize the SEC to impose civil penalties in cease-and-desist proceedings. Prior to the Act, the SEC was prohibited from seeking civil monetary penalties in such proceedings. Additionally, for cease-and-desist proceedings instituted under the Securities Act, the Act adopts a three-tiered penalty grid. **Sec. 929P (pp. 496-498).**

Specifically, the Act amends Section 8A of the Securities Act by adding a new subsection which authorizes the SEC to impose a civil penalty on a person in a cease-and-desist proceeding, if the SEC finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Securities Act, or is or was a cause of such violation, and that such penalty is in the public interest. Previously, the SEC was not able to impose civil penalties in such proceedings. The Act establishes a three-tiered system of penalties. Absent aggravating circumstances, the maximum penalty for an act or omission is $7,500 for a natural person and $75,000 for any other person. If the act or omission involves fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement, the maximum penalty is $75,000 for a natural person and $375,000 for any other person. If the act or omission involves fraud, deceit, manipulation or deliberate or reckless disregard of a regulatory requirement and results in substantial losses or a risk of substantial losses, or substantial pecuniary gain to the violator, the maximum penalty is $150,000 for a natural person and $725,000 for any other person. The SEC may consider a respondent's ability to pay in determining an appropriate penalty. **Sec. 929P(a) (pp. 496-497).**

The Act amends Section 21B(a) of the Exchange Act by adding a provision that provides that in any proceeding instituted under Section 21C of the Exchange Act (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Exchange Act, or is or was a cause of such violation. **Sec. 929P(a) (p. 497).**

The Act amends Section 9(d)(1) of the ICA by adding a provision that provides that in any proceeding instituted pursuant to Section 9(f) of the ICA (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the ICA, or is or was a cause of such violation. **Sec. 929P(a) (pp. 497-498).**

The Act amends Section 203(i)(1) of the Advisers Act by adding a provision that provides that in any proceeding instituted pursuant to Section 203(k) of the Advisers Act (relating to cease-and-desist proceedings), the SEC may impose a civil penalty if it finds, on the record, after notice and a hearing, that such person is violating or has violated any provision of the Advisers Act, or is or was a cause of such violation. **Sec. 929P(a) (p. 498).**

By giving the SEC the ability to seek an order requiring payment of a civil money penalty in cease-and-desist proceedings, the Act makes available to the SEC a key enforcement remedy that was previously available only in administrative proceedings involving broker dealers, investment advisers, investment companies and their associated persons.

This new authority gives the SEC and its enforcement division a powerful incentive to bring more cases as administrative actions. Such actions can be disadvantageous to potential defendants in that (1) administrative actions go to hearing on an accelerated schedule; (2) there is no discovery in administrative proceedings; (3) there is no right of trial by jury; and (4) factual findings by the SEC in an administrative proceeding can only be reversed on appeal if the defendant shows that the findings failed to meet the "substantial evidence" test.

b. Extraterritorial Jurisdiction of the Antifraud Provisions of the Federal Securities Laws

The Act adds new, nearly identical subsections to the Securities Act, the Exchange Act, and the Advisers Act, which provide that district courts have jurisdiction of an action or proceeding brought or instituted by the SEC or the United States alleging a violation of certain provisions of the respective acts involving (i) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the transaction occurs outside the United States and involves only foreign investors, or (ii) conduct occurring outside the United States that has a foreseeable substantial effect within the United States. The provision specified for the Securities Act is Section 17(a). The provisions specified for the Exchange Act are the antifraud provisions of that title. The provision specified for the Advisers Act is Section 206. **Sec. 929P(b) (pp. 498-499).**

In addition, the Act requires the SEC to solicit public comment and then conduct a study to determine the extent to which private rights of action under the antifraud provisions of the Exchange Act should be extended to cover conduct within the United States that constitutes a significant step in furtherance of the violation, even if the transaction occurs outside the United States and involves only foreign investors, and conduct occurring outside the United States that has a foreseeable substantial effect within the United States. The study must consider and analyze (i) the scope of such a private right of action, including whether it should extend to all private actors or whether it should be more limited to extend just to institutional investors or otherwise; (ii) what implications such a private right of action would have on international

comity; (iii) the economic costs and benefits of extending a private right of action for transnational securities frauds; and (iv) whether a narrower extraterritorial standard should be adopted. A report of the study must be submitted and recommendations made to the Senate Banking committee and the House Financial Services Committee within 18 months after enactment of the Act. **Sec. 929Y (p. 505).**

The Act does not overturn the Supreme Court's June 2010 decision in *Morrison v. National Australia Bank, N.A.*, ___ U.S. ___, No. 08-1191 (June 24, 2010), which rejected the notion that the Exchange Act applies to private claims by foreign investors relating to transactions on foreign exchanges. The Act does, however, provide United States courts with extraterritorial jurisdiction over certain cases brought by the SEC and the United States. Also, this provision is significant as it extends SEC and federal criminal jurisdiction to foreign private issuers whose securities trade in the United States and to persons trading in securities abroad that may have an effect on securities markets within the United States.

The Act also directs the SEC to consider whether extraterritorial jurisdiction should apply to private actions based on the antifraud provisions of the Exchange Act.

c. Control Person Liability Under the Exchange Act

The Act amends Section 20(a) of the Exchange Act, which provides for joint and several liability of control persons, to provide that such liability includes liability to the SEC in any action brought under paragraphs (1) or (3) of Section 21(d) of the Exchange Act, which relate to injunctive proceedings and money penalties in civil actions, respectively. **Sec. 929P(c) (p. 499).**

19. Fingerprinting

The Act amends Section 17(f)(2) of the Exchange Act, which requires that every member of a national securities exchange, broker, dealer, registered transfer agent, and registered clearing agency require that its partners, directors, officers, and employees be fingerprinted, to include registered securities information processors, national exchanges, and national securities associations in the list of organizations whose members must require fingerprinting of their partners, directors, officers, and employees. **Sec. 929S (p. 501).**

20. Deadline for Completing Examinations, Inspections and Enforcement Actions

The Act amends the Exchange Act by inserting new Section 4E, which requires the SEC staff to, within 180 days of providing a written Wells notification to any person, either file an action against such person or notify the Director of the Division of Enforcement of its intent not to file an action. This deadline can be extended for additional 180 day periods if the Director of the Division of Enforcement or a designee of the Director decides that it is necessary because of the complexity of the case and notifies the Chairman of the SEC. **Sec. 929U (pp. 501-502).**

New Section 4E also requires the SEC staff to, within 180 days after the later of completion of its on-site examination or receipt of all requested records, either notify the entity being examined or inspected that the examination or inspection has concluded, has concluded without findings, or that the staff requests the entity to take corrective action. This deadline can

be extended for one additional 180 day period if the head of any office or division decides that it is necessary because of the complexity of the case and notifies the Chairman of the SEC. **Sec. 929U (p. 502).**

21. Securities Investor Protection Act Amendments

The Act amends Section 4(a)(1)(C) of the SIPA to change the minimum assessment paid by SIPC members from $150 per annum to 0.02 percent of the gross revenues from the securities business of such member. **Sec. 929V(a) (p. 502).**

The Act amends Section 14(c) of the SIPA by increasing the maximum fine for prohibited acts from $50,000 to $250,000. **Sec. 929V(b) (p. 502).**

The Act also amends Section 14 of the SIPA by adding new subsection (d), which prohibits a person from falsely representing, with actual knowledge of the falsity of the representation and with intent to deceive or cause injury, that such person or another person is a member of SIPC or that any person or account is protected or is eligible for protection by SIPC. The new subsection provides that violators can be fined up to $250,000 or imprisoned for up to 5 years. The new subsection also indicates that any court with jurisdiction of a civil action arising under the SIPA may grant reasonable temporary and final injunctions, which injunctions may be served anywhere in the United States and are operative throughout the United States. **Sec. 929V(c) (pp. 502-503).**

22. Short Sale Reforms

The Act amends Section 13(f) of the Exchange Act, which relates to reports by institutional investment managers, by adding a new paragraph that requires the SEC to prescribe rules providing for the public disclosure of the name of the issuer and the title, class, CUSIP number, aggregate amount of the number of short sales of each security, and any additional information it determines to be necessary and appropriate. Such disclosure is to be made following the end of the reporting period and must occur every month. **Sec. 929X(a) (p. 504).**

The Act amends Section 9 of the Exchange Act, which relates to manipulation of securities prices, by adding a new subsection that makes it unlawful for any person, directly or indirectly, by use of interstate commerce or any facility of a national securities exchange, or for any member of a national securities exchange to effect, alone or otherwise, a manipulative short sale of a security. The new subsection requires the SEC to issue rules to ensure that the appropriate enforcement options and remedies are available for violations of the subsection. **Sec. 929X(b) (p. 504).**

The Act amends Section 15 of the Exchange Act, which relates to registration and regulation of broker and dealers, by adding new subsection (e), which requires every broker or dealer to provide notice to its customers that they may elect not to allow their fully paid securities to be used in connection with short sales. The new subsection also requires that if a broker or dealer uses a customer's securities in connection with short sales, the broker or dealer must notify the customer that the broker or dealer may receive compensation in connection with lending the customer's securities. The new subsection allows the SEC to determine, by rule, the form, content, time and manner of delivery of any notice required. **Sec. 929X(c) (pp. 504-505).**

23. GAO Study on Securities Litigation

The Act requires the Comptroller General of the United States to conduct a study on the impact of authorizing a private right of action against any person who aids or abets another person in violation of the securities laws. Such study must include (i) a review of the role of secondary actors in companies' issuance of securities; (ii) the courts' interpretation of the scope of liability for secondary actors under Federal securities laws after January 14, 2008; and (iii) the types of lawsuits decided under the Private Securities Litigation Act of 1995. A report of this study must be submitted to Congress within one year of enactment of the Act. **Sec. 929Z (p. 505).**

C. Improvements to the Regulation of Credit Rating Agencies

1. Elimination of Regulation FD Exemption

Section 939B of the Act requires the SEC to amend Regulation FD to remove the express exemption for communications with rating agencies that is set forth in Section 100(b)(2)(iii) of Regulation FD. The Act requires the SEC to revise Regulation FD on or before October 19, 2010 (90 days after enactment).

If the SEC amends Regulation FD in the exact manner specified in the Act, we do not expect this provision to have significant consequences. Regulation FD was designed to prevent selective disclosure of material nonpublic information to market participants. Rule 100(b)(1) sets forth a list of persons (broker-dealers, investment advisers, institutional money managers, investment companies and shareholders if it is reasonably foreseeable that they will trade on the basis of the information) with whom communications by an issuer or issuer representative trigger a duty of public disclosure under Regulation FD. At the time that Regulation FD was adopted, most rating agencies were registered with the SEC as investment advisers. Accordingly, to permit communications with rating agencies without triggering Regulation FD, Rule 100(b)(2)(iii) contains an exemption under which communications to rating agencies generally would not trigger Regulation FD. Since Regulation FD was adopted, however, rating agencies are now regulated under Exchange Act Section 15E, and the rating agencies that have qualified as nationally recognized statistical rating organizations ("NRSROs") generally have terminated their registration as investment advisers. Accordingly, even without the exclusion set forth in Rule 100(b)(2)(iii), rating agencies are not covered persons that trigger Regulation FD. Instead, communicating with a rating agency can be viewed as equivalent to communicating with a news reporter or with a company's commercial bank. Even if the SEC were to amend Regulation FD to include rating agencies as covered persons that trigger Regulation FD, it would not be necessary to publicly disclose information provided to a rating agency if the rating agency agreed to maintain the information in confidence, consistent with Rule 100(b)(2)(ii) of Regulation FD.

2. Rescission of Securities Act Rule 436(g)

Section 939G of the Act provides that Securities Act of 1933 (the "Securities Act") Rule 436(g) "shall have no force or effect." Securities Act Rule 436(g) provided that credit ratings issued by NRSROs on debt securities, a class of convertible debt securities or a class of preferred stock were not considered part of a registration statement prepared or certified by a person within

the meaning of Sections 7 and 11 of the Securities Act. This provision reflected the view of the SEC that, without Rule 436(g), a credit rating is a statement by a person whose profession gives authority to the statement made by it, and thus is "expertized" for purposes of the Securities Act. Under the Securities Act, if a statement made by an expert is included or referred to in a Securities Act registration statement, the expert is subject to potential liability under Section 11 of the Securities Act (subject to a due diligence defense) and the issuer is required to file the expert's consent to being named in the registration statement. In connection with passage of the Act, the three major rating agencies operating in the U.S. have stated that they are not in a position to consent to being named as experts in Securities Act registration statements.

The repeal of Rule 436(g) takes effect July 22, 2010 (one day after enactment).

The repeal of Rule 436(g) has a number of significant implications for public companies and the public offering process.

a. Incorporation by Reference of Exchange Act Disclosure.

Many issuers include statements in their Forms 10-K, 10-Q and 8-K regarding their credit ratings or changes to their credit ratings. These statements are automatically incorporated by reference into such issuers' registration statements on Forms S-3, S-4 or S-8. For example, a company's Form 10-K Management's Discussion and Analysis might have a discussion of the liquidity effect of a past credit ratings downgrade or discuss loan covenants that are dependent on credit ratings. We understand from discussions with the SEC Staff that, consistent with an October 2009 SEC rule proposal relating to the use of credit ratings in registered offerings, disclosure of credit ratings in this context should not be considered to be a use in connection with an offering of securities, and thus would not trigger the consent requirements of the Securities Act. Accordingly, discussion of credit ratings for the limited purpose of disclosing changes to a credit rating, the liquidity of the registrant, the cost of funds for a registrant or the terms of agreements that refer to credit ratings, may be acceptable if the credit rating is not otherwise used in connection with a registered offering. Moreover, Section 19(a) of the Securities Act provides that no liability may attach under the Securities Act for actions taken in good faith in conformity with an SEC rule notwithstanding that the rule is subsequently rescinded. Thus, with respect to credit ratings that were incorporated by reference into or that were included in a Securities Act registration statement that became effective before July 22, 2010, there would appear to be little purpose to requiring a rating agency's consent for such credit ratings disclosure since Section 19(a) would prevent expertized liability from arising with respect to credit ratings in this circumstance. However, with respect to registration statements that become effective, or are amended, on or after July 22, 2010, companies will have to take care not to include or refer to credit ratings, including through incorporation by reference, unless they have obtained the rating agency's consent. Companies also must use caution with respect to references to credit ratings in Form 10-Ks filed on or after July 22, 2010, unless such references are made in a context consistent with the interpretive position discussed above, since the filing of a Form 10-K is deemed to effect a post-effective amendment to a registration statement.

b. Prospectus Supplements, Free Writing Prospectuses and Other Offering Material.

Disclosures of credit ratings in free-writing prospectuses under Rule 433 of the Securities Act, including pricing term sheets, and in press releases that comply with Securities Act Rule 134 do not trigger the consent requirements because these communications are not subject to Section 11. Similarly, offerings that are exempt from Securities Act registration, such as Rule 144A and Regulation S offerings, should not be affected by the rescission of Rule 436(g). In contrast, offerings of asset backed securities that are registered under the Securities Act, which have traditionally been marketed conditioned upon assignment of a specified credit rating and that, as a result, are subject to a special Securities Act rule that requires inclusion of credit ratings in the registration statement, will be suspended (or conducted as Rule 144A offerings) until the markets find a means to accommodate the rescission of Rule 436(g).

D. Improvements to the Asset-Backed Securitization Process

1. Regulation of Credit Risk Retention

a. Definition of Asset-Backed Securities

ABS is defined under new Section 3(a)(77) of the Exchange Act as “a fixed-income or other security collateralized by any type of self-liquidating financial asset (including a loan, a lease, a mortgage, or a secured or unsecured receivable) that allows the holder of the security to receive payments that depend primarily on cash flow from the asset, including a collateralized mortgage obligation, a collateralized debt obligation, a collateralized bond obligation, a collateralized debt obligation of asset-backed securities, a collateralized debt obligation of collateralized debt obligations, and any security that the [SEC], by rule, determines to be an asset-backed security.” The definition excludes securities issued by a finance subsidiary that are held by a parent company or a company controlled by the parent company if none of the securities issued by the finance subsidiary are held by an entity that is not controlled by the parent company. **Sec. 941(a) (pp. 524-525)**.

b. Credit Risk Retention Requirement

New Section 15G of the Exchange Act requires the Comptroller, the Fed, and the FDIC (collectively the “Banking Agencies”) and the SEC to jointly prescribe, within 270 days of enactment of the Act, regulations that require any securitizer to retain an economic interest in a portion of the credit risk for any asset that the securitizer transfers, sells, or conveys to a third party through the issuance of an ABS. A “securitizer” is defined as an issuer of an asset-backed security or a person who originates and initiates an asset-backed security transaction by selling and transferring assets, either directly or indirectly, including through an affiliate, to an issuer. **Sec. 941(b) (p. 525)**.

The Banking Agencies, the SEC, the Secretary of Housing and Urban Development, and the Federal Housing Finance Agency (jointly the “Housing Agencies”) are required to jointly promulgate, within 270 days of enactment of the Act, regulations requiring securitizers to retain an economic interest in a portion of the credit risk for any residential mortgage asset that the securitizer transfers, sells, or conveys to a third party through the issuance of an asset-backed

security. **Sec. 941(b) (p. 525)**.

The regulations to be promulgated under this section would become effective with respect to securitizers and originators of ABS backed by residential mortgages one year after the date that final regulations are published in the Federal Register. **Sec. 941(b) (p. 530)**.

These risk-retention requirements are similar to those already included in the SEC's proposed amendments to its rules governing the use of "shelf registration" statements for ABS and to its Regulation AB, governing the disclosure required to be included in such registration statements (the "Proposed Regulation AB Amendments"). Those proposed amendments would require a minimum 5% risk retention, but would apply only to securitizers that sought to use shelf registration for an offering of ABS. The regulations to be promulgated under new Section 15G of the Exchange Act would apply to all ABS, no matter how they are offered and sold to investors, except those eligible for one of the exemptions described below.

c. Specific Standards for Retention of Credit Risk

The regulations requiring retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other ABS must:

- Prohibit a securitizer from hedging or otherwise transferring the credit risk that the securitizer is required to retain with respect to an asset;
- Require a securitizer to retain at least 5% of the credit risk for any asset that is not a "qualified residential mortgage" that is transferred, sold or conveyed through an asset-backed security issued by the securitizer, or that is a "qualified residential mortgage" that is transferred, sold, conveyed through an asset-backed security issued by the securitizer if one or more of the assets that collateralize the asset-backed security are not "qualified residential mortgages." Less than 5% of the credit risk for any asset that is not a "qualified residential mortgage" may be retained if the securitizer meets certain underwriting standards established by the Banking Agencies. The term "qualified residential mortgage" is to be defined by the SEC and the Banking and Housing Agencies according to specified criteria, but is to be no broader than the term "qualified mortgage" as defined under Section 129C(c)(2) of the Truth in Lending Act ("TILA"), as amended by the Consumer Financial Protection Act of 2010 and regulations adopted thereunder;
- Specify the permissible forms of risk retention, the minimum duration of the required risk retention, and that a securitizer is not required to retain any part of the credit risk for an asset that is transferred, sold, or conveyed by the securitizer through the issuance of an ABS if all the assets that collateralize the asset-backed security are "qualified residential mortgages";
- Apply to all securitizers, including those that are "insured depository institutions" within the meaning of the FDI Act;
- With respect to commercial mortgages, specify the permissible types, forms and amounts

of risk retention (which may include retention of a specific amount or percentage of the total credit risk of the asset, the retention of the first-loss position by a third party purchaser that meets listed requirements, a determination by the Federal banking agencies and the SEC that the underwriting standards and controls for the asset are adequate, and provision of adequate representations and warranties and related enforcement mechanisms;

- Establish appropriate standards for retention of an economic interest with respect to collateralized debt obligations, securities collateralized by collateralized debt obligations, and similar instruments collateralized by other ABS;
- Provide, as the Banking Agencies and the SEC jointly deem appropriate, for the allocation of risk retention obligations between a securitizer and an originator in the case of a securitizer that purchases assets from an originator. An "originator" is defined as a person who, through the extension of credit or otherwise, creates a financial asset that collateralizes an asset-backed security and sells an asset directly or indirectly to a securitizer;
- Establish asset classes with separate rules for securitizers of different classes of assets, including residential mortgages, commercial mortgages, commercial loans, auto loans, and any other class of assets that the Banking and Housing Agencies deem appropriate;
- Establish exemptions, exceptions, and adjustments to the rules promulgated as would help ensure high quality underwriting standards and encourage appropriate risk management practices for securitizers and originators, improve consumer and business access to credit on reasonable terms, or otherwise be in the public interest and for the protection of investors; and
- Coordinate risk retention obligations between a securitizer and an originator by reducing the percentage risk retention obligations of the securitizer by the percentage of risk retention obligations required of the originator, considering whether assets sold to the securitizer have terms, conditions and characteristics that reflect low credit risk, whether the form and volume of transactions in the securitizations markets create incentives for imprudent organization of the type of asset to be sold to the securitizer, and the potential impact of the risk retention obligations on consumer and business access to credit on reasonable terms, which may not include the transfer of credit risk to a third party **Sec. 941(c)-(d) (pp. 526-527)**.

d. Exemptions, Exceptions and Adjustments

The Banking Agencies and the SEC are to exempt the following from the credit risk retention regulations:

i. Loans or other financial assets made, guaranteed, or purchased by any institution supervised by the Farm Credit Administration, including the Federal Agricultural Mortgage Corporation;

ii. Residential, multifamily, or healthcare facility mortgage loan assets, or securitizations based directly or indirectly on such assets, which are insured or guaranteed by the U. S. government (which would presumably include the Government National Mortgage Association ("GNMA")), but not by Fannie Mae, Freddie Mac, or any Federal home loan bank; and

iii. Qualified residential mortgages, but not excluding any ABS that is collateralized by tranches of other asset-backed securities. **Sec. 941(b) (pp. 528-529)**.

In addition, the SEC must provide for a total or partial exemption of any securitization, as appropriate in the public interest and for the protection of investors, including assets issued or guaranteed by the United States, a state, a political subdivision of a state, or any agency or instrumentality thereof (specifically excluding Fannie Mae and Freddie Mac). **Sec. 941(e) (p. 527)**.

e. Study on Risk Retention

Subtitle D directs the Banking Agencies and the SEC to conduct a study of the combined impact on each individual class of asset-backed security of the new credit risk retention requirements, including the effect of the requirements on increasing the market for federally subsidized loans, and of Financial Accounting Statements 166 and 167. This report, including any statutory and regulatory recommendations, is due to Congress within 90 days of enactment of the Act. **Sec. 941(c) (p. 530)**.

2. Disclosures and Reporting for Asset-Backed Securities

The subtitle instructs the SEC to promulgate regulations requiring issuers of ABS to disclose, for each tranche or class of security, information regarding the assets backing that security, including, among other things, the nature and extent of the compensation of the broker or originator of the assets backing the security and the amount of risk retention by the originator and securitizer. **Sec. 942(b) (p. 531)**. Similar disclosure requirements are contained in the SEC's Proposed Regulation AB Amendments.

Subtitle D also requires continued supplemental and periodic reporting under the Exchange Act for issuers of ABS, even if the number of record holders of the securities is less than 300 persons. (A similar requirement is in the SEC's Proposed Regulation AB Amendments, but only with respect to securitzers that use shelf registration.) The subtitle authorizes the SEC to suspend or terminate this filing requirement for any class of ABS on such terms and for such periods as the SEC deems necessary or appropriate. **Sec. 942(a) (pp. 530-531)**.

3. Representations and Warranties in Asset-Backed Securities Offerings

Within 180 days of enactment of the Act, the SEC is required to prescribe regulations on the use of representations and warranties in the market for ABS. These regulations are to require NRSROs to include in any report accompanying a credit rating a description of the representations, warranties, and enforcement mechanisms available to investors, and how those

differ from representations, warranties, and enforcement mechanisms in issuances of similar securities. In addition, securitizers must be required to disclose fulfilled and unfulfilled repurchase requests across all trusts aggregated by the securitizer so that investors can identify those originators with underwriting deficiencies. **Sec. 943 (pp. 531-532)**.

4. Exempted Transactions under the 1933 Act

Section 4(5) of the 1933 Act, which exempts certain qualifying offers and sales of mortgage notes from registration under the 1933 Act, is repealed in its entirety. **Sec. 944 (p. 532)**.

5. Due Diligence Analysis and Disclosure in Asset-Backed Securities Issues

Within six months of enactment of the Act, the SEC is to issue rules requiring the issuer of an asset-backed security to perform a review of the assets underlying the asset-backed security and to disclose the nature of the review in the issuer's registration statement required to be filed under the Exchange Act. **Sec. 945 (p. 532)**.

6. Study on the Macroeconomic Effects of Risk Retention Requirements

The Council's Chairman is instructed to perform a study on the macroeconomic effects of the risk retention requirements issued under Subtitle D, particularly the potential beneficial effects to stabilizing the real estate market. This report is to be submitted to Congress within six months of enactment of the Act. **Sec. 946 (pp. 532-533)**.

E. Accountability and Executive Compensation

Subtitle E of Title IX contains executive compensation provisions, most of which apply to all public companies. The subtitle amends certain provisions of the Exchange Act, to impose substantive requirements and enhance disclosure obligations related to compensation practices. In addition, a provision in the subtitle also requires that federally regulated financial institutions provide enhanced compensation disclosures and prohibits incentive-based compensation arrangements that encourage "inappropriate risks" at federally regulated financial institutions.

1. Non-Binding Shareholder Vote on Executive Compensation ("Say-on-Pay")

Section 951 of the Act adds a new Section 14A to the Exchange Act that requires every public company to hold an annual, biennial or triennial non-binding shareholder advisory vote ("say-on-pay") to approve the compensation of named executive officers as disclosed pursuant to the executive compensation requirements of Item 402 of Regulation S-K. The Act makes clear that the say-on-pay votes are non-binding and will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties. Companies also are required to provide for a shareholder vote no less frequently than every six years on a separate resolution to determine whether the say-on-pay vote will take place every one, two or three years. The first shareholder say-on-pay vote and first shareholder vote on the frequency of say-on-pay votes must take place at the first annual or other shareholder meeting occurring on or after January 21, 2011 (six months after enactment). **Sec. 951 (pp. 533-534)**.

Unlike the EESA, which required all TARP recipients to hold say-on-pay votes, the Act does not mandate that the SEC adopt rules or regulations to implement this provision, although the SEC has general rulemaking authority under the Exchange Act. In addition, the Act grants the SEC the authority to exempt companies from the provision taking into account, among other factors, whether the requirement disproportionately burdens small issuers.

Under current SEC rules, say-on-pay votes conducted by companies other than TARP recipients require the issuer to file a preliminary proxy statement, although we expect that the SEC will amend its rules to eliminate this requirement. The SEC also might provide guidance on how the say-on-pay vote resolution and the resolution on the frequency of say-on-pay votes can be phrased. Notably, under current SEC rules, it would be unlawful for a company to offer three alternatives with respect to the shareholder vote on the frequency of say-on-pay votes (see Rule 14a-4(b) under the Exchange Act), and such a vote raises a number of significant practical issues, including what standard is necessary for a particular alternative to be approved.

2. Disclosure of and Non-Binding Shareholder Vote on Golden Parachute Compensation

New Section 14A of the Exchange Act also provides that, in connection with a shareholder vote to approve an acquisition, merger, consolidation, or proposed sale or other disposition of all or substantially all the assets of a company, each person soliciting votes on the transaction must: (1) disclose any agreements or understandings with named executive officers concerning any compensation that is based on or otherwise relates to the transaction and the total of all such compensation ("golden parachute compensation"); and (2) hold a separate non-binding shareholder advisory vote on such agreements, understandings and compensation, unless such agreements or understandings already have been subject to a say-on-pay vote by shareholders. The Act requires that the disclosure be prescribed by SEC regulations and cover all types of compensation (i.e., present, deferred or contingent), the aggregate total of the compensation and any conditions to which the compensation is subject. As with say-on-pay votes, the golden parachute advisory votes will not overrule any decision of the company or its board of directors or otherwise affect the board's fiduciary duties. The provision applies to all public companies, although the SEC has the authority to exempt companies taking into account, among other factors, whether the provision disproportionately burdens small issuers. New Section 14A's golden parachute provision applies to shareholder meetings occurring on or after January 21, 2011 (six months after enactment). **Sec. 951 (pp. 533-534)**.

In light of the golden parachute compensation provision, companies and executives may be inclined to more definitively establish change-in-control compensation arrangements in advance, so that such arrangements can be subject to approval under a say-on-pay vote instead of being separately voted on in the context of a merger, although the parameters of what it means for an agreement or understanding to have been the subject of previous say-on-pay votes by shareholders are somewhat ambiguous. Note that, depending on a transaction's circumstances, two shareholder votes on golden parachute compensation may be required, one each for the acquiring company and target company.

3. Disclosure of Institutional Investment Manager Say-on-Pay and Golden Parachute Votes

New Section 14A also requires that institutional investment managers subject to Section 13(f) of the Exchange Act disclose no less than annually how they voted on any say-on-pay and golden parachute matters. Institutional investment managers who already are required by the SEC to report how they have voted are exempt from this requirement. The requirement applies to say-on-pay and golden parachute votes that take place on or after January 21, 2011 (six months after enactment). **Sec. 951 (p. 534).**

This provision will result in increased publicity surrounding, and likely activist investor pressure on, Schedule 13F institutional money managers with respect to their proxy voting. Schedule 13Fs are filed by entities or persons who manage more than $100 million in specified exchange traded securities. While the rules will apply to entities beyond those investment companies and investment managers reporting their voting results under existing SEC rules, firms that deal primarily in options and derivatives, rather than underlying securities, may escape this provision since those securities do not count toward the Schedule 13F reporting threshold.

4. Compensation Committee Independence

Section 952 of the Act mandates that stock exchanges adopt listing standards requiring listed companies to have independent compensation committee members. Section 952 also mandates that compensation committees assess the independence of compensation consultants and other advisers to the compensation committee (including legal counsel). The requirements of Section 952 are included in a new Section 10C of the Exchange Act. The provisions of Section 10C are to be implemented through exchange listing standards. Section 10C does not apply to controlled companies. The exchanges have authority to exempt companies from Section 10C's listing requirements as they determine appropriate, taking into account the potential impact on smaller companies. Section 10C requires the SEC to adopt rules no later than July 16, 2011 (360 days after enactment), directing the exchanges to prohibit the listing of any company not in compliance with the new section's requirements. **Sec. 952 (pp. 534-537)**.

Section 10C(a) requires that each member of a board's compensation committee be independent under a definition of independence to be established by the exchanges. In adopting this definition, the exchanges must consider the sources of compensation paid to any compensation committee member (including any consulting, advisory or other compensatory fees paid) and whether the member is affiliated with the issuer. Companies will be provided with a reasonable opportunity to cure any defects prior to delisting. While the other provisions of Section 10C apply to all listed companies other than controlled companies, the exclusions in Section 10C(a) are broader, as the subsection applies to all listed companies other than controlled companies, limited partnerships, companies in bankruptcy, registered open-ended investment management companies and foreign private issuers that provide annual disclosures to shareholders of the reasons why they do not have an independent compensation committee. **Sec. 952 (pp. 534-535)**.

Section 10C(b) requires that any compensation consultant and other adviser to the compensation committee may only be selected after the compensation committee has taken into

account independence factors to be established by the SEC, which factors must be competitively neutral and preserve the ability of compensation committees to retain any category of adviser. These factors must include: (1) provision of other services by the employer of the compensation consultant or adviser; (2) the amount of fees received by the employer of the compensation consultant or adviser as a percentage of its total revenue; (3) policies of the employer of the compensation consultant or adviser that are designed to prevent conflicts of interest; (4) any business or personal relationship between the compensation consultant or adviser and a member of the compensation committee; and (5) any stock of the issuer owned by the compensation consultant or adviser. **Sec. 952 (pp. 535-536)**.

Section 10C(c) provides that a compensation committee in its sole discretion may retain or obtain the advice of a compensation consultant and must be directly responsible for the appointment, compensation and oversight of a compensation consultant. However, the committee is not required to follow the recommendations of such consultant and must continue to exercise its own judgment in fulfilling its duties. In each proxy statement filed by an issuer for an annual meeting occurring on or after July 21, 2011 (the first anniversary of the Act's enactment), the company must disclose whether the compensation committee has retained or obtained the advice of a compensation consultant, whether the consultant's work raised any conflicts of interest and how any such conflicts are being addressed. **Sec. 952 (p. 536)**.

Section 10C(d) provides that a compensation committee also in its sole discretion may retain or obtain the advice of independent legal counsel and other advisers. Again, the committee must be directly responsible for the appointment, compensation and oversight of these advisers, but is not required to follow the recommendation of such counsel or advisers to the compensation committee. **Sec. 952 (p. 536)**.

Under Section 10C(e), issuers are required to provide appropriate funding for compensation consultants, independent legal counsel and other advisers to the compensation committee. **Sec. 952 (p. 537)**.

The compensation committee member independence provision largely parallels Exchange Act Section 10A applicable to audit committee members, and thus Rule 10A-3 under the Exchange Act provides a guide to what the listing standards for compensation committee member independence might entail, although the Act's provision is not as prescriptive. In contrast to Section 10A, Section 10C does not require compensation committees to retain any consultant or adviser used by the company. Further, the compensation committee is not required to use only independent advisers (although the statute refers to "independent legal counsel," it also allows the committee to retain "other advisers"). The disclosure requirements regarding the compensation committee's use of and independence analysis regarding compensation consultants are broader than recently adopted SEC rules regarding fees paid to compensation consultants, and thus will require disclosures of other factors (including, for example, family relationships with the consultant or the consultant's reliance on an engagement for a significant portion of his or her business) that could affect compensation consultant independence.

5. Executive Compensation Disclosures

Section 953 of the Act adds a new Section 14(i) to the Exchange Act that directs the SEC

to adopt rules requiring each public company to disclose in its annual meeting proxy statement the relationship between executive compensation "actually paid" and the company's financial performance. The presentation is required to "take into account" changes in the value of the shares of stock and dividends of the company and any distributions. The disclosure may, but is not required to, include a graphic representation of this required information. The Act does not prescribe a time period in which the SEC must adopt rules implementing the "pay versus performance" disclosure requirement. **Sec. 953(a) (pp. 537-538)**.

A stock price performance graph is required to be included in a company's annual report to shareholders pursuant to existing SEC rules (see Item 201(e) of Regulation S-K), but the Act's provision is more prescriptive than the current rules and requires that companies present an explicit comparison between pay and financial performance, although it is not required to be in graphic form. This provision, along with the required say-on-pay vote, may cause companies to rethink some of the disclosure in their Compensation Discussion and Analysis ("CD&A") and focus more on graphical presentations of the links between pay and performance in various elements of compensation.

Section 953 of the Act also directs the SEC to amend Item 402 of Regulation S-K (17 C.F.R. § 229.402) to require each public company to disclose in its SEC filings described in Item 10(a) of Regulation S-K (such as its annual proxy statement): (1) the median of annual total compensation of all employees, other than the CEO (or any equivalent position); (2) the annual total compensation of the CEO (or any equivalent position); and (3) the ratio of those two amounts. For the purposes of complying with this requirement, "total compensation" must be determined in accordance with Item 402(c) of Regulation S-K (17 C.F.R. § 229.402(c)), as in effect the day before the Act's enactment. The Act does not prescribe a time period in which the SEC must adopt rules implementing the internal pay ratio disclosure requirement. **Sec. 953(b) (p. 538)**.

This provision likely will be the most difficult, expensive and time-consuming of the Act's executive compensation provisions applicable to public companies and could impose an enormous burden on companies of all sizes. Given the complexity of calculating total compensation under Item 402(c) for named executive officers, the difficulty of calculating total compensation for all employees should not be underestimated. In addition to issues such as what point in time the calculation must be done and which employees must be included (full time employees only, employees on medical or military leave, etc.), the provision will raise a host of interpretive questions that do not normally arise with respect to executive officers, such as whether statutorily prescribed benefits provided to employees in some countries are treated as perquisites.

6. Recovery of Erroneously Awarded Compensation (Clawback)

Section 954 of the Act adds a new Section 10D to the Exchange Act that requires the SEC to direct the exchanges to prohibit the listing of any company that does not adopt "clawback" policies to recover compensation in certain circumstances. Specifically, each listed company must adopt and implement a policy: (1) for disclosure of the company's policy for incentive-based compensation that is based on the financial information required to be reported under the securities laws; and (2) to recoup from any current or former executive officers

incentive compensation paid during a three-year look-back period based on erroneous data if the company is required to prepare an accounting restatement due to material noncompliance with any financial reporting requirement under the securities laws, regardless of whether the individual was involved in misconduct that led to the restatement. The amount to be recovered is the excess of what would have been paid under the restated financial statements. The Act does not specify a time period in which the SEC is required to direct the exchanges to adopt these rules relating to clawback policies. **Sec. 954 (pp. 538-539)**.

The Act's clawback provision represents a middle ground between the provision applicable to TARP recipients under EESA and the current provision applicable to all public companies under SOX, but is more stringent than the clawback provisions voluntarily adopted by many companies. Under SOX, the clawback is limited in scope (i.e., applicable only to the Chief Executive Officer and Chief Financial Officer), duration (i.e., a twelve month look-back period) and grounds (i.e., misconduct is required). The clawback provision under EESA is not triggered by an accounting restatement, but only requires a material inaccuracy in the company's financial statements and/or performance metrics and does not contain a misconduct requirement.

There also are some ambiguities in the provision that will need to be addressed by SEC rulemaking. For example, while the provision refers to equity compensation, it is not clear that clawback policies are required to apply to all forms of equity awards, or only equity awards that are granted or vest on the basis of financial performance. In particular, institutional investors typically do not view time-vested options and stock awards as "incentive compensation" and the value of such awards is not directly tied to information reported in a company's financial statements. Note also that because the clawback policies mandated by the Act will be adopted pursuant to listing standards, it does not appear that they will be enforceable in private actions.

7. Disclosures Regarding Employee and Director Hedging

Section 955 of the Act adds a new Section 14(j) to the Exchange Act that directs the SEC to adopt rules requiring each public company to disclose in its annual proxy statement whether its employees or directors (or any of their designees) may purchase financial instruments that are designed to hedge or offset decreases in the value of securities granted to employees or directors as a part of employee compensation or other securities held directly or indirectly by the employees or directors. The Act does not prescribe a time period in which the SEC must adopt rules implementing the hedging policy disclosure requirement. **Sec. 955 (p. 539)**.

While this provision requires disclosure of policies applicable to all employees, it does not prevent an issuer from having (and disclosing) one policy that is applicable to its directors and executives and another policy applicable to rank-and-file employees. In this regard, many companies already have such policies in place for their directors and executive officers and disclose them in their CD&A.

8. Enhanced Compensation Disclosures and Certain Compensation Prohibitions for Regulated Financial Institutions

Section 956 of the Act imposes new requirements on incentive compensation paid by covered financial institutions with more than $1 billion in assets. For the purposes of this

provision, a "covered financial institution" means a depository institution, registered broker-dealer, credit union, investment adviser, Fannie Mae, Freddie Mac and any other financial institution that federal regulators determine should be covered. Section 956 requires covered financial institutions to disclose to their respective federal regulators the structure of all incentive-based compensation arrangements sufficient to determine whether: (1) excessive compensation, fees or benefits are provided to executive officers, other employees, directors or principal shareholders; and (2) the incentive-based compensation arrangements could lead to material financial losses to the institution. In addition, the Act requires applicable financial regulators to prohibit incentive-based payment arrangements that in their determination encourage "inappropriate risks" by covered financial institutions, either by providing excessive compensation or by creating the possibility of material financial losses to the institution.

Although the Act does not define "excessive compensation," it does direct federal regulators to consider the compensation standards included in Section 39(c) of the Federal Deposit Insurance Act, which take into account the combined value of all benefits provided to the individual, the financial condition of the institution and the levels of compensation at comparable institutions, among other factors.

The applicable federal regulators, including the Fed, OCC, FDIC, OTS, National Credit Union Administration Board, Federal Housing Finance Agency and the SEC, are required to prescribe jointly regulations or guidelines for this provision no later than April 21, 2011 (nine months after enactment). **Sec. 956 (pp. 539-540)**.

9. Voting by Brokers

Section 957 of the Act amends Section 6(b) of the Exchange Act to require exchanges to prohibit a broker that is not the beneficial owner of a company's shares (e.g., shares held in street name on behalf of retail investors) from granting a proxy to vote the shares in connection with a shareholder vote in director elections, with respect to executive compensation or on "any other significant matter" (as determined by the SEC by rule) unless the beneficial owner has provided the broker with voting instructions. The Act does not prescribe a time by which exchanges are required to implement policies relating to the broker voting prohibition, but could be read as requiring immediate action. **Sec. 957 (pp. 540-541)**.

In effect, this provision codifies and expands the effect of the SEC's July 2009 approval of amendments to NYSE Rule 452 to eliminate uninstructed broker voting in uncontested director elections so that it also applies to say-on-pay votes and other significant matters. The provision is likely to be most significant with respect to say-on-pay votes mandated by the Act.

F. Improvements to the Management of the Securities and Exchange Commission

1. Report on Oversight of National Securities Associations

The Act requires the Comptroller General to submit to the Banking Committees a report evaluating the SEC's oversight of national securities associations registered with the SEC. **Sec. 964 (p. 545)**.

The report must evaluate the SEC's oversight with respect to: (i) the governance of such

national securities associations, including the identification and management of conflicts of interest by such national securities associations; (ii) the examinations carried out by the national securities associations; (iii) the executive compensation practices of such national securities associations; (iv) the arbitration services provided by the national securities associations; (v) the review performed by national securities associations of advertising by their members; (vi) the cooperation with and assistance to State securities administrators by the national securities associations to promote investor protection; (vii) how the funding of national securities associations is used to support the mission of the national securities associations; (viii) the policies regarding the employment of former employees of national securities associations by regulated entities; (ix) the ongoing effectiveness of the rules of the national securities associations in achieving the goals of the rules; (x) the transparency of governance and activities of the national securities associations; and (xi) any other issue that has an impact, as determined by the Comptroller General, on the effectiveness of such national securities associations in performing their mission and in dealing fairly with investors and members. **Sec. 964 (p. 545)**.

This report must be submitted within 2 years after enactment of the Act and every 3 years thereafter. The Act requires the SEC to reimburse the GAO for the cost of making these reports. **Sec. 964 (pp. 545-546)**.

2. Compliance Examiners

The Act requires the Division of Trading and Markets and the Division of Investment Management to each have a staff of examiners. These examiners must perform compliance inspections and examinations of entities under the jurisdiction of their respective division and must report to the director of their respective division. **Sec. 965 (p. 546)**.

The Divisions' examination staffs are expected to supplement, but not replace, the Office of Compliance Inspections and Examinations.

G. Strengthening Corporate Governance

Subtitle G of Title IX contains amendments to the Exchange Act intended to strengthen corporate governance practices.

1. Proxy Access

Section 971 of the Act amends Section 14(a) of the Exchange Act by inserting a new Subsection (2) stating that the SEC may, but is not required to, adopt rules and regulations relating to the ability of shareholders to nominate directors in an issuer's proxy statement. Section 971 grants the SEC the authority to exempt companies from any proxy access rules, taking into account, among other factors, whether the rules disproportionately burden small issuers. **Sec. 971 (p. 549)**.

In June 2009, the SEC issued proposed proxy access rules that would: (1) establish a federal proxy access right pursuant to proposed Rule 14a-11 and related amendments; and (2) permit proxy access shareholder proposals pursuant to an amendment to Rule 14a-8 (see SEC Release No. 33-9046). The proposed Rule 14a-11 would allow a shareholder or group of shareholders to nominate directors and have those nominees included in a company's proxy

materials if the shareholder or group beneficially owned a certain minimum percentage (ranging from 1-5%) of the company's voting shares for at least one year prior to submitting the nomination. The proposed amendment to Rule 14a-8 would require companies to include shareholder proposals relating to proxy access in their proxy materials, except in limited circumstances. The SEC received hundreds of comments in response to the proposed proxy access rules, some of which questioned the SEC's authority to implement the rules. The SEC currently is considering final adoption of proxy access rules.

2. Separation of Chairman and CEO

Section 972 of the Act amends Section 14B of the Exchange Act by adding a new subsection that directs the SEC to adopt rules, no later than 180 days after enactment, requiring each public company to disclose in its annual proxy statement the reasons why it has chosen the same person, or different people, to serve as chairman of the board of directors and chief executive officer (or in equivalent positions of the issuer). **Sec. 972 (pp. 549-550)**.

The Act's disclosure-based approach is similar to the proxy disclosure rules adopted by the SEC in December 2009. These rules require enhanced disclosure about a company's board leadership structure, including a discussion of: (1) whether the company has combined or separated the CEO and chairman positions; (2) if combined, whether the company has a lead independent director and the specific role of such director in the company's leadership; and (3) why the company believes its structure is the most appropriate for the company. Given the similarities between what the Act requires and the rules adopted in December 2009 by the SEC, it appears that the Act does not require the SEC to significantly alter its current rules.

H. Municipal Securities

1. Regulation of Municipal Securities and Changes to the Board of the Municipal Securities Rulemaking Board

The Act generally expands the scope and powers of the Municipal Securities Rulemaking Board (the "MSRB"), expressly authorizing the MSRB to create information systems and to assess fees and charges in connection with the operation of these systems. All of these provisions are effective on October 1, 2010. **Sec. 975(i) (p. 558)**.

Specifically, Section 15B and related provisions of the Exchange Act are amended to require municipal advisors that provide advice to or on behalf of a municipal entity or obligated person with respect to municipal financial products or the issuance of municipal securities or municipal advisors that undertake the solicitation of a municipal entity or obligated person to register with the SEC. Currently, Section 15B only requires the registration of municipal securities brokers and dealers. **Sec. 975(a) (p. 550)**.

The composition of the MSRB was revised to require that a majority of members are independent of the municipal security industry. Accordingly, there will be eight independent public representatives, including one investor, one municipal entity, and one member of the general public. The remaining MSRB members will consist of seven individuals associated with a broker, dealer, municipal securities dealer, or municipal advisor, including one non-bank associated representative, one bank-associated representative, and one municipal advisor. While

these numbers may be adjusted, the Act requires the MSRB to include more public representatives than advisor representatives and to require as even a division as possible between the two categories of representatives. **Sec. 975(b) (pp. 550-554)**.

The MSRB is required to draft rules requiring municipal advisors, in addition to municipal securities brokers and dealers, to meet certain qualification standards and other requirements found by the MSRB to be necessary for the protection of investors, municipal entities, or obligated persons. Municipal advisors will have a fiduciary duty to municipal entities. More specifically, the MSRB will be required to draft rules requiring municipal advisors to meet continuing education requirements, professional standards, and fiduciary obligations to any municipal entity that the advisor advises. The SEC will enforce these rules. The Act also generally expands the scope and powers of the MSRB, expressly authorizing the MSRB to create information systems and to assess fees and charges in connection with the operation of these systems. **Sec. 975(b)-(c) (pp. 550-555)**.

2. Study of Increased Disclosure to Investors

The Act would require the Comptroller General to conduct a study on the disclosures required to be made by issuers of municipal securities and to make recommendations relating to these disclosure requirements, including the advisability of repealing Section 15B(d) of the Exchange Act. The Comptroller's report would be due to Congress within two years of enactment of the Act. **Sec. 976 (p. 558)**.

3. Study on the Municipal Securities Markets

The Act would also require the Comptroller General to conduct a study on the municipal securities markets, among other things comparing these markets with the corporate securities markets, and to submit a report of its findings to the Senate Banking Committee and the House Financial Services Committee within 18 months of enactment of the Act. The report will contain an analysis of the needs of the markets and investors and recommendations for how to improve the transparency, efficiency, fairness, and liquidity of trading in the municipal securities markets. Within six months of submission of the report, the SEC is instructed to submit a response detailing the actions it has taken to address the Comptroller's recommendations. **Sec. 977 (p. 559)**.

4. Funding for Government Accounting Standards Board

The Act would amend Section 19 of the Exchange Act to require a national securities association registered under the Exchange Act to establish a reasonable annual accounting support fee to fund the budget of the Government Accounting Standards Board (the "GASB"). **Sec. 978(a) (pp. 559-560)**.

The Comptroller General, in consultation with state and local government officials, would be required to study the role and importance of the GASB and the manner and level at which the GASB has been funded. This report would be due to the Senate Banking Committee and House Financial Services Committee within six months of enactment of the Act. **Sec. 978(b) (p. 560)**.

5. SEC Office of Municipal Securities

The Act would create an Office of Municipal Securities in the SEC, which will be charged with administering the rules of the SEC with respect to municipal securities brokers, dealers, advisors, issuers, and investors. The Office of Municipal Securities is required to coordinate with the MSRB on rulemaking and enforcement activities. **Sec. 979 (pp. 560-561)**.

The requirement that the MSRB draft rules to require the registration of municipal securities advisors is not unexpected in light of prior MSRB proposals.

I. Public Company Accounting Oversight Board

In relation to the Public Company Accounting Oversight Board (the "PCAOB"), Subtitle I amends SOX to: (i) allow the PCAOB to share information collected during an investigation of a public accounting firm with foreign auditor oversight authorities under certain circumstances; and (ii) clarify the PCAOB's jurisdiction over brokers and dealers and the public accounting firms that prepare their audit reports.

1. Sharing Information with Foreign Authorities

The provisions of Section 981 are intended to deal with the problem of cooperation with foreign auditor oversight authorities under the original SOX. Because the PCAOB could not inspect all of the registered foreign accounting firms, it needed to rely in some measure on local regulators in countries that had robust regulatory regimes. However, a number of countries were hostile towards a U.S. regulatory body attempting to inspect their citizens. As a result, in a number of countries, arrangements were reached for joint inspections or inspections where the local regulator would inspect facilities in the home country and the PCAOB would inspect facilities in the United States. These arrangements never worked very well because the PCAOB could not share documents with foreign regulators.

Subtitle I amends Section 105(b)(5) of SOX to provide that the PCAOB may, at its discretion, share information that it collects during an investigation of a public accounting firm with a foreign auditor oversight authority under certain circumstances. The PCAOB may share such information if a foreign government has empowered a foreign auditor oversight authority to inspect or otherwise enforce laws with respect to a public accounting firm, and if: (i) the PCAOB finds that it is necessary to accomplish the purposes of SOX; (ii) the foreign auditor oversight authority provides any assurances of confidentiality that the PCAOB requests, a description of the applicable information systems and controls of the foreign auditor oversight authority; and (iii) the PCAOB determines that it is appropriate to share such information. **Sec. 981 (p. 561)**.

A foreign auditor oversight authority is defined as a governmental body or other entity empowered by a foreign government to conduct inspections of public accounting firms or otherwise to administer or enforce laws related to the regulation of public accounting firms. **Sec. 981 (p. 283-284)**.

2. Oversight of Broker-Dealers

The provisions of Section 982 clarify the PCAOB's authority over broker-dealer auditors.

Although the PCAOB could have always inspected such auditors under SOX, the SEC was given the power to exempt such firms from PCAOB registration and inspection. For the first five or six years after SOX became effective, the SEC granted broker-dealer auditors an annual exemption. Under Section 982, such firms would clearly be subject to registration, inspection and disclosure requirements of the PCAOB.

a. Expansion of the PCAOB's Authority

Subtitle I amends Section 101 of SOX to impose registration and disclosure requirements on public accounting firms that furnish audit reports with respect to brokers and dealers, as well as to issuers. **Sec. 982 (p. 563-564)**. Such accounting firms would also be subject to investigations, disciplinary proceedings, and fees. **Sec. 982 (p. 564-565)**. A broker is defined as a person engaged in the business of effecting transactions in securities for the account of others, that is required to file a balance sheet, income statement, or other financial statement under the Exchange Act, where such financial statement is required to be certified by a registered public accounting firm. **Sec. 982(a) (p. 562)**. A dealer is defined as any person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise, that is required to file a balance sheet, income statement or other financial statement under the Exchange Act, where such financial statement is required to be certified by a registered public accounting firm. **Sec. 982(a) (p. 562)**.

Subtitle I also expands the PCAOB's oversight authority from public accounting firms that service public companies to those that service all companies subject to the securities laws. **Sec. 982(b) (p. 563)**.

b. Inspections of Audit Reports for Brokers and Dealers

The PCAOB may, by rule, conduct and require a program of inspection of registered public accounting firms that provide one or more audit reports for a broker or dealer. In establishing such a program, the PCAOB may allow for differentiation among classes of brokers and dealers, as appropriate. In establishing any inspection schedules, the PCAOB must consider whether differing schedules would be appropriate with respect to registered public accounting firms that issue audit reports only for one or more brokers or dealers that do not receive, handle, or hold customer securities or cash or are not a member of the SIPC. Any rules established by the PCAOB must be subject to prior approval by the SEC. If a public accounting firm is exempt from any such program, it is not required to register with the PCAOB. **Sec. 982(e) (p. 563-564)**.

c. Investigations and Disciplinary Proceedings

Subtitle I would amend Section 105(c)(7)(B) of SOX to provide that it is unlawful for any person that is suspended or barred from being associated with a registered public accounting firm under that subsection, to become or remain associated with any issuer, broker or dealer in an accounting or a financial management capacity. It is also unlawful for any issuer, broker, or dealer that knew or should have known, through the exercise of reasonable care, of such suspension or bar, to permit such association without the consent of the PCAOB or the SEC. **Sec. 982(f) (p. 564)**.

d. Foreign Public Accounting Firms

Section 106(a) of SOX will be amended to provide that any foreign public accounting firm that prepares or furnishes an audit report with respect to any issuer, broker, or dealer must be subject to SOX and the rules of the PCAOB and the SEC issued pursuant to SOX, in the same manner and to the same extent as a U.S. public accounting firm; except that registration with the PCAOB will not subject such foreign public accounting firms to the jurisdiction of the federal or state courts, other than with respect to controversies between such firms and the PCAOB. The PCAOB may, by rule, determine that a foreign public accounting firm, or class of such firms, that does not issue audit reports nonetheless plays such a substantial role in the preparation and furnishing of such reports for particular issuers, brokers or dealers, that is necessary or appropriate and in the public interest for the protection of investors that such a firm should be treated as a public accounting firm for purposes of registration with the PCAOB. **Sec. 982(g) (p. 564)**.

e. Funding

Section 109(d) of SOX provides that the PCAOB must establish a reasonable annual accounting support fee to maintain itself. Subtitle I will amend Section 109(d)(2) to specify that the rules of the PCAOB will provide for equitable allocation, assessment, and collection of the fee among brokers and dealers, as well as issuers. The PCAOB must also allow for differentiation among classes of brokers and dealers, as well as issuers, as appropriate. **Sec. 982(h) (p. 564)**.

The PCAOB will begin the allocation, assessment, and collection of fees with respect to brokers and dealers with the payment of support fees to fund the first full fiscal year beginning after the date of enactment of the IPSRA. **Sec. 982(h) (p. 565)**.

Any amount due from a broker or dealer (or a particular class of brokers or dealers) must be allocated among the brokers and dealers and payable by the broker or dealer (or the brokers and dealers in a particular class). The amount due from a broker or dealer must be in proportion to the net capital of the broker or dealer (before or after any adjustments), compared to the total net capital of all brokers and dealers (before or after any adjustments), in accordance with rules issued by the PCAOB. **Sec. 982(h) (p. 565)**.

f. Referral of Investigations to a Self-Regulatory Organization

The PCAOB must be permitted to refer an investigation to a SRO in the case of an investigation that concerns an audit report for a broker or dealer that is under the jurisdiction of such SRO. **Sec. 982(i) (p. 565).** The PCAOB may also, in its discretion, turn over any confidential information collected in an investigation with respect to an audit report for a broker or dealer to an SRO, if the broker or dealer is under such SRO's jurisdiction and the PCAOB finds it necessary to accomplish the purposes of SOX or to protect investors. **Sec. 982(j) (p. 565)**.

J. SEC Match Funding

Subtitle J of Title IX contains provisions relating to SEC funding, including funding

authorizations for fiscal year 2011 through fiscal year 2015, changes to the budget transmittal process and the establishment of an SEC reserve fund.

1. Annual Funding Authorizations for Fiscal Year 2011 to Fiscal Year 2015

The subtitle amends Section 35 of the Exchange Act to authorize the following amounts of annual funding for the SEC: $1.3 billion for fiscal year 2011, $1.5 billion for fiscal year 2012, $1.75 billion for fiscal year 2013, $2.0 billion for fiscal year 2014, and $2.25 billion for fiscal year 2015. (For comparison purposes, note that the SEC budget for fiscal year 2010 was $1.119 billion.) Congress still must appropriate funding for the SEC for each fiscal year, even though the preceding amounts are authorized by the Act. **Sec. 991(c) (pp. 588-589)**.

2. Transmittal of SEC Budget Requests

The subtitle includes provisions relating to the submission of the SEC's budget that will take effect beginning in fiscal year 2012. Specifically, the subtitle amends Section 31 of the Exchange Act to provide that, after the SEC submits its annual budget to the President, the President must submit the SEC's budget to Congress "in unaltered form." The subtitle requires that the SEC include in each budget (a) an itemization of the amount of funding needed to carry out the SEC's functions, (b) an amount to be designated as contingency funding to address unanticipated needs and (c) a designation of any SEC activities for which multi-year budget authority would be suitable. **Sec. 991(d) (p. 589)**.

3. Establishment of SEC Reserve Fund

Dodd-Frank also amends Section 4 of the Exchange Act to establish a separate SEC reserve fund in the U.S. Treasury. The Act provides that the SEC must fund the reserve fund from registration fees collected under Section 6(b) of the Securities Act of 1933 and Section 24(f) of the Investment Company Act of 1940. Up to the first $50 million of such registration fees collected by the SEC annually will be deposited in the reserve fund, provided that the total balance of the reserve fund may not exceed $100 million for any given fiscal year. The SEC may use up to the full balance of the reserve fund during any given fiscal year, as the SEC determines is necessary to carry out its functions. This provision is effective October 1, 2011. **Sec. 991(e) (pp. 589-590)**.