A fast take on the impact of the Dodd-Frank Act on asset management firms

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Following the financial crisis, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank), was adopted into law in the US in July 2010. The law is intended to reduce risks to the financial system by imposing new requirements to prohibit or curtail activities, improve transparency, extend regulation to previously unregulated activities, and provide regulators with new powers.

Dodd-Frank requires various US regulatory agencies to propose and adopt specific rules to implement it. These rules are in various stages of proposal, adoption and effectiveness.

Several provisions of Dodd-Frank impact the asset management industry, either directly as regulated investment advisers, or indirectly as participants in the markets. The primary ways that Dodd-Frank impacts asset managers are summarized below, along with links to more detailed descriptions of each of the regulations, their intent, timing and impact.

Investment Adviser Registration

In June 2011, the Securities and Exchange Commission (SEC) adopted final rules to require many advisers to private funds -- hedge funds and private equity funds -- which were previously exempt from registration -- to become registered as investment advisers with the SEC by March 30, 2012. Registration entails significant new regulatory and compliance obligations.

Link: A Closer Look: Impact on Asset Managers

The final rules also establish new exemptions from the adviser registration rules applicable to advisers to: venture capital funds; funds with less than $150 million; certain foreign private advisers. Non-US advisers may rely on any of the exemptions, which are described in the link above. Advisers located outside the US that have US investors in private funds may be required to register.

Transparency

Investment advisers are subject to enhanced requirements to provide data and information to regulators and to investors, as described below. Non-US advisers may be subject to these provisions.

- ***Form ADV Part 1.*** The SEC adopted new reporting requirements for investment advisers to report information to the SEC on Form ADV. All advisers must provide information regarding their advisory business, including the types of clients they advise, their employees, and their advisory activities, any business practices that may present significant conflicts of interest, their non-advisory activities, and their financial industry affiliations. Private fund advisers must provide additional information about each fund they advise.

  Link: A Closer Look: Impact on Asset Managers

- ***Form ADV Part 2.*** The SEC adopted new rules intended to improve the quality of information provided by SEC-registered advisers to advisory clients. Advisers must include certain key information about the advisory firm in a narrative "brochure" filed with Form ADV, and provide clients with information about key advisory personnel in a brochure supplement.

  Link: FS Regulatory Brief: Amendments to Form ADV Part 2

- ***Exempt Reporting Advisers.*** Even if exempt from registration, many advisers will still need to submit abbreviated reports to the SEC on Form ADV. Advisers who rely on either the venture capital exemption or the exemption for funds with less than $150 million will need to submit periodic reports as "exempt reporting advisers."

  Link: FS Regulatory Brief: New Reporting Requirements for "Exempt Reporting Advisers"

- ***Form PF (Private Fund).*** To aid regulators in evaluating systemic risk in the financial system, the SEC and the Commodities Futures Trading Commission (CFTC) adopted rules requiring registered advisers to provide a range of information concerning the private funds they advise on new Form PF, beginning in the summer 2012.

  Link: A Closer Look: Reporting by Private Fund Advisers on Form PF

The Volcker Rule

The Volcker Rule part of Dodd-Frank is intended to limit risk to banking institutions by prohibiting them from engaging in proprietary trading and also limiting their ownership or sponsorship of a hedge fund or other covered fund. As currently proposed, the rule would prohibit proprietary trading not only by FDIC-insured institutions, but also in any affiliate of an FDIC-insured institution—irrespective of its business or geographic location. It would require that banking organizations limit ownership in certain covered funds (including hedge funds, private equity funds, commodity funds and "foreign equivalent funds") and impose restrictions on seeding new funds.

Link: A Closer Look: The Volcker Rule Proposal: A focus on proprietary trading

Link: A Closer Look: The Volcker Rule Proposal: Regulators Propose Restrictions on "Covered Funds"

Link: FS Regulatory Brief: Volcker hearing: continued uncertainty is the only certainty

Systemically Important Financial Institutions (SIFIs)

Dodd-Frank requires that regulators identify those financial institutions that are "systemically important," and subject them to greater regulation and oversight intended to reduce risks to the financial system. There are three types of "systemically important financial institutions" (SIFIs): bank holding companies with more than $50 billion in assets; foreign banks with US operations with $50 billion in total worldwide assets; and US or foreign non-bank financial companies designated as systemically important. Regulators have not yet designated the US or foreign non-banks that are systemically important, though have stated that hedge funds, private equity firms and asset management firms may pose risks that are not well-measured by quantitative thresholds, and require further study.

Link: A Closer Look: The FSOC SIFI Designation Proposal for Nonbank Financial Companies

Resolution Plans for SIFIs

In order to assure that large, systemically important institutions could be wound down in an orderly manner if need be, "covered companies" must create a resolution plan, or "living will," for the rapid and orderly resolution of the company under the US bankruptcy code. A covered company includes: a US bank holding company with $50 billion or more in consolidated assets; a foreign banking organization that is a bank holding company or that has US branches or agencies and total assets of $50 billion or more on a worldwide basis; and designated nonbank SIFIs.

Link: FS Regulatory Brief: Domestic SIFIs - FDIC Final Rule on Resolution Plans

Removal of Credit Ratings

Dodd-Frank imposes a number of requirements on credit rating agencies, including, among other things, imposing new liability exposure, mandating new internal control requirements and changes in their governance, imposing specific prohibitions to address conflicts of interest, requiring new methodologies and procedures to be used in the rating process, increasing oversight, and removing the use of ratings in government regulations. Many asset managers consider credit ratings in their investment decision-making process. Since the publication of the *Closer Look* linked below, the SEC has proposed additional rules to implement Dodd-Frank's mandate.

Link: A Closer Look: Impact on Credit Rating Agencies

A Uniform Fiduciary Duty

Dodd-Frank required the SEC to evaluate the existing standard of care that broker-dealers and investment advisers owe when providing personalized investment and recommendations about securities to retail customers. Currently, advisers are required to adhere to a fiduciary standard, and broker-dealers have a duty to provide suitable advice. The SEC released its study in January 2011, and concluded that retail consumers should be uniformly protected when receiving investment advice and recommending that a "uniform fiduciary standard" be imposed for investment advisers and broker-dealers. Additional rulemaking would be required to do so.

Link: A Closer Look: A Uniform Fiduciary Duty for Broker-Dealers and Investment Advisers

Swaps

Dodd Frank requires that swap dealers register with the CFTC and securities-based swap dealers register with the SEC, and that swaps and security-based swaps, to the greatest extent possible, be traded on an exchange and cleared through a central counterparty to reduce risk. Companies that use swaps will face new regulatory, business and operational challenges as dealers, counterparties and other swap market participants become subject to new clearing, margin and collateral requirements, record-keeping and reporting duties, and new trade execution alternatives. Rules are in various stages of effectiveness and are described below.

Link: FS Regulatory Brief: Swap Dealer-MSP Registration to Start and External Business Conduct Rules are Final

Link: A Closer Look: Derivatives Regulation and Changing Market Infrastructure for Nonfinancial Companies

Link: A Closer Look: Swap Dealers and Major Swap Participants

Link: A Closer Look: Impact on Swap Data Reporting

Link: A Closer Look: Impact on OTC Derivatives

Whistleblower Rule

Dodd-Frank required the SEC to create a new program to encourage "whistleblowers" to come forward. Under the SEC's new program, it will pay awards (of between 10% and 30% of the amount obtained) to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the federal securities laws that leads to a successful enforcement action in which the SEC obtains monetary sanctions totaling more than $1 million. The CFTC also has recently adopted a whistleblower program.

Link: A Closer Look: The SEC Adopts Final Rules Establishing Whistleblower Program

Incentive-Based Compensation

Dodd-Frank requires regulators to adopt rules that require enhanced disclosure of incentive-based compensation and prohibit covered financial institutions -- including investment advisers -- from offering any type of incentive-based compensation that, in the regulators' determination, provides excessive compensation or could expose the institution to inappropriate risks that could lead to material financial loss. This rule is in the proposal stage and has not yet been adopted.

Link: A Closer Look: Incentive-Based Compensation Requirements for Certain Firms

Possible Self-Regulatory Organization

Dodd-Frank required that the SEC study ways to enhance the oversight of registered investment advisers. The SEC's study recommended alternative approaches to address its resource and staffing challenges: the creation of one or more self-regulatory examinations to oversee all SEC-registered investment advisers, or charging user fees for SEC examinations. Additional rule-making would be required for either option.

Link: A Closer Look: SEC Study of Investment Oversight

Investment Advisers to Commodity Funds: Registration with the CFTC

On February 9, 2012, the CFTC required private fund managers and SEC-registered investment companies that have portfolio holdings in commodity interests to become registered with the CFTC, unless they meet new criteria for exemption. Registration, in turn, will have a significant impact on the advisers as it will impose new CFTC-driven obligations, including disclosures to customers and regulatory reporting requirements. Advisers subject to the new rules must register by December 31, 2012, and the new filing requirements are phased in beginning September 2012. These rules were not mandated by Dodd-Frank, though they are consistent with the requirement that advisers to private funds register with the SEC (described at number 1, above).

Link: FS Regulatory Brief: CFTC Adopts New Rules Requiring Advisers to Investment Companies and Private Funds to Register

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For more information about how PwC can help you with regulatory issues, please contact:

Dan Ryan
Chairman, FS Regulatory Practice
646 471 8488
daniel.ryan@us.pwc.com

Lori Richards
Co-leader, Asset Management Regulatory Practice
703 610 7513
lori.richards@us.pwc.com

Anthony Conte
Co-leader, Asset Management Regulatory Practice
646 471 2898
anthony.conte@us.pwc.com

Robert Nisi
Co-leader, Asset Management Regulatory Practice
415 498 7169
robert.nisi@us.pwc.com

For more information about PwC's asset management practice, please contact:

Barry Benjamin
US & Global Asset Management Leader
410 659 3400
barry.p.benjamin@us.pwc.com

Gary Meltzer
US Asset Management Advisory Leader
646 471 8763
gary.c.meltzer@us.pwc.com

Shawn Baker
US Tax Leader for Traditional Funds
617 530 7340
shawn.k.baker@us.pwc.com

Mark Casella
US Alternative Investment Leader
646 471 2500
mark.j.casella@us.pwc.com

Paul Ryan
US Tax Leader for Real Estate
646 471 8419
paul.ryan@us.pwc.com

Tim Conlon
US Real Estate Leader
646 471 7700
timothy.c.conlon@us.pwc.com

Paula Smith
US Assurance Leader for Alternative Investments
617 530 7906
paula.e.smith@us.pwc.com

Peter Finnerty
US Assurance Leader for Traditional Funds
617 530 4566
peter.finnerty@us.pwc.com

Will Taggart
US & Global Asset Management Tax Leader
646 471 2780
william.taggart@us.pwc.com