

## Heads Up

### In This Issue:

- Introduction
- Finalized Provisions
- Proposed Provisions
- Provisions That Are Yet To Come

Over the past year, the SEC has finalized a number of provisions, completed a number of studies and reports for Congress, and exposed various proposals for public comment.

## Dodd-Frank Turns One — A Recap of the Act's First Year

by Joe DiLeo and Elsyé Putri, Deloitte & Touche LLP

### Introduction

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Act" or the "Dodd-Frank Act"), arguably one of the most extensive pieces of legislation in U.S. history. Enacted in the wake of the financial crisis and affecting registrants in numerous industries, the Act calls for hundreds of new rules and regulations, over 50 studies, and the creation of both new regulators and new areas of responsibility for existing regulators.<sup>1</sup>

The Act aims to (1) promote U.S. financial stability by "improving accountability and transparency in the financial system," (2) put an end to the notion of "too big to fail," (3) "protect the American taxpayer by ending bailouts," and (4) "protect consumers from abusive financial services practices." To achieve these broad objectives, the Act includes many provisions whose magnitude will not be fully appreciated until regulators have implemented them by adopting new rules and regulations. In this vein, over the past year, the SEC has finalized a number of provisions, completed a number of studies and reports for Congress, and exposed various proposals for public comment.

This *Heads Up* summarizes the current status of certain of the Act's key provisions that affect a large cross-section of SEC registrants. These provisions include those on corporate governance, executive compensation, asset-backed securities (ABSs), over-the-counter (OTC) derivatives and swaps, and specialized disclosures. For convenience, this publication categorizes the provisions under three main headings:

- Provisions that have been finalized.
- Provisions that have been proposed or are in post-comment deliberations.
- Provisions that are yet to come.

For additional details about the Act and its ramifications, see Deloitte's publication *The Dodd-Frank Act's Impact on Public Companies: After One Year* on the Corporate Governance Web site.

**Editor's Note:** Although the Dodd-Frank Act focuses on the U.S. financial services sector, there are sure to be impacts on nonfinancial companies as well. For example, the Act includes provisions that are aimed at reducing risk in lending practices. These provisions may result in increased borrowing costs for other companies, especially those considered high-risk debtors.

<sup>1</sup> By one law firm's count, the Act requires over six regulatory agencies to create 243 rules, conduct 67 studies, and issue 22 periodic reports.

## Finalized Provisions

### Exemptions From Section 404(b) of the Sarbanes-Oxley Act

On September 15, 2010, the SEC issued a [final rule](#)<sup>2</sup> (which became effective on September 21, 2010) that offers companies with a public float of \$75 million or less an exemption from obtaining an independent auditor's report on the effectiveness of their internal control over financial reporting (ICFR) under Section 404(b) of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley"). The rule was issued to conform with Section 404(c) of Sarbanes-Oxley (added by Section 989A of the Dodd-Frank Act). Note that the exemption does not extend to management's assessment of the effectiveness of ICFR, which continues to be required by Section 404(a).

In addition, on April 22, 2011, the SEC published the results of an Act-mandated [study](#) addressing whether the SEC could reduce the costs of compliance with Section 404(b) for public companies with a public float of \$75 million to \$250 million while still "maintaining investor protections." The SEC concluded that "auditor involvement promotes more accurate and reliable reporting" in the assessment of ICFR and that Section 404(b) should continue to apply to such companies.

### Whistleblower Rule

On May 25, 2011, the SEC issued a [final rule](#)<sup>3</sup> (which passed narrowly by a 3–2 vote) to implement the whistleblower provisions under Section 21F (added by Section 922 of the Dodd-Frank Act) of the Securities Exchange Act of 1934 (the "Exchange Act"). The final rule provides financial rewards for whistleblowers who give the SEC "original information" leading to securities law enforcement actions that recover more than \$1 million.

Whistleblowers are encouraged, but not required, to report the information internally before reporting it to the SEC. In addition to addressing the amount of and eligibility criteria for the awards, the final rule discusses the anti-retaliatory provisions of Section 21F as well as the eligibility to receive an award of whistleblowers who are themselves culpable of misconduct.

As part of the Dodd-Frank Act's effort to modify SEC authority and operations to better protect the investing community, the SEC has created an Office of the Whistleblower, which is responsible for administering the whistleblower program, including determining and providing awards.

The whistleblower rules are one of the more controversial provisions of the Dodd-Frank Act.

**Editor's Note:** The whistleblower rules are one of the more controversial provisions of the Dodd-Frank Act. Some opponents of these rules fear that companies' internal control systems could be undermined because the rules allow whistleblowers to go to the SEC directly. While the final rule includes a provision that allows whistleblowers to report, within a 120-day grace period, original information to the SEC that was first reported internally, some have argued that the grace period may not be sufficient to resolve such matters internally.

### Corporate Governance and Executive Compensation

On December 16, 2009, the SEC issued a [final rule](#)<sup>4</sup> (which became effective on February 28, 2010) requiring companies to disclose in their proxy statements (1) whether the roles of the chairman of the board of directors and the CEO are separate or combined and (2) why they believe their selected structure is appropriate. While this rule is not directly attributable to the Dodd-Frank Act, it is consistent with the Act's requirements. In addition, in September 2010, the SEC approved [exchange rules](#) that prohibit broker voting on director elections and executive compensation.

<sup>2</sup> SEC Final Rule Release No. 33-9142, *Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers*.

<sup>3</sup> SEC Final Rule Release No. 34-64545, *Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934*.

<sup>4</sup> SEC Final Rule Release No. 33-9089, *Proxy Disclosure Enhancements*.

The Act includes many provisions that are intended to reform how credit rating agencies operate.

Further, on January 25, 2011, in response to Section 951 of the Dodd-Frank Act, the SEC issued a [final rule](#)<sup>5</sup> on executive compensation, including shareholder advisory votes, frequency of votes on executive compensation, and shareholder advisory votes on golden parachutes (commonly known as “say on pay,” “say on frequency,” and “say on golden parachutes,” respectively). Although shareholders’ votes are advisory and nonbinding, the SEC acknowledges the importance of the Act’s objective to engage shareholders in discussions about executive compensation.

The “say on pay” and “say on frequency” rules will become effective on January 21, 2013, for smaller reporting companies and became effective on January 21, 2011, for all other companies. The “say on golden parachutes” rules became effective on April 25, 2011.

## Securities Ratings

The Act includes many provisions that are intended to reform how credit rating agencies, or nationally recognized statistical rating organizations (NRSROs), operate and imposes significant structural, regulatory, and liability reforms on these agencies. Congress concluded that overreliance on NRSROs for investing decisions was a major cause of the financial crisis, particularly with respect to ABSs and other structured products.

On July 26, 2011, in view of Section 939A of the Dodd-Frank Act, the SEC issued a [final rule](#)<sup>6</sup> that addresses the use of credit ratings in the offering of securities. The rule provides alternative requirements that replace those that currently rely on, or make special accommodations for, security ratings offered on short-form registration statements (e.g., offerings of nonconvertible securities rated as “investment grade” by at least one NRSRO on Forms S-3 and F-3). Such alternative requirements (1) include measures of creditworthiness based on the amount of nonconvertible securities a registrant has outstanding or has issued for cash as of or over defined periods and (2) are similar to those by which a registrant could attain “well-known seasoned issuer” status. The rule becomes effective on September 2, 2011, and contains a temporary grandfathering provision that allows an issuer to use short-form registrations for three years from the effective date.

## Proposed Provisions

### Rating Agencies

Under the Dodd-Frank Act, the enforcement and penalty provisions of the Securities Exchange Act of 1933 should be applied to opinions included in prospectuses by NRSROs in the same manner as they are applied to audit opinions included in a registrant’s financial statements. As a result, NRSROs have stopped allowing issuers to include ratings opinions in their offering materials. The SEC has also indefinitely waived the requirement that such ratings opinions be included in registered offerings.

The Act also imposes operational changes on NRSROs, such as changes in personnel, governance, and business practices. For example, the Act requires NRSROs to (1) provide transparent disclosures regarding their ratings performance, ratings methodologies, and historical ratings performance and (2) have annual reporting processes. In addition, NRSROs are potentially required to make due diligence reports provided by third parties, such as independent auditors, publicly available if the reports are used to derive initial credit ratings or to make changes to subsequent credit ratings. The SEC has proposed a [rule](#)<sup>7</sup> on this topic on which comments were due by August 8, 2011.

The Dodd-Frank Act continues to call for references to credit ratings to be removed from a number of laws, including the Federal Deposit Insurance Act, the Investment Company Act, and the Exchange Act. The Act also requires the SEC to submit to Congress the results of a study that addresses whether NRSROs should be assigned by a central board. In addition, the SEC is in the process of (1) establishing a required Office of Credit Ratings and (2) preparing to conduct annual examinations of NRSROs, on the basis of which it will publish examination reports.

<sup>5</sup> SEC Final Rule Release No. 33-9178, *Shareholder Approval of Executive Compensation and Golden Parachute Compensation*.

<sup>6</sup> SEC Final Rule Release No. 33-9245, *Security Ratings*.

<sup>7</sup> SEC Proposed Rule Release No. 34-64514, *Proposed Rules for Nationally Recognized Statistical Rating Organizations*.

## The Dodd-Frank Act requires the SEC to provide additional oversight over broker-dealers.

### ABS Reforms and Credit Risk Retention

In light of the Dodd-Frank Act, the SEC reissued, on July 26, 2011, its [proposed rule](#)<sup>8</sup> on ABS reforms. The rule would require ABS issuers to disclose additional data for securitized assets, “if such data are necessary for investors to independently perform due diligence.” The objective of the rule is to keep registered ABS offerings in the public reporting system permanently.

In addition, in response to Section 15G of the Exchange Act (added by the Dodd-Frank Act), the SEC, together with five other regulatory agencies, has issued a [proposed rule](#)<sup>9</sup> to implement the requirement for ABS issuers to retain 5 percent of the credit risk in an ABS deal.

**Editor’s Note:** Given the complexity of the credit risk retention rule, particularly regarding how credit risk could be measured, as well as the efforts that will be needed to coordinate views on comments submitted to six different agencies, the comment period for the rule was extended to August 1, 2011. We therefore would not expect the rule to be finalized soon.

### Broker-Dealer Reports

The Dodd-Frank Act requires the SEC to provide additional oversight over broker-dealers. On June 15, 2011, the SEC unanimously proposed [amendments](#)<sup>10</sup> to the broker-dealer financial reporting rules under the Exchange Act. The goal of the proposed amendments is to “facilitate the ability of the [PCAOB] to implement oversight of independent public accountants of broker-dealers” and to require broker-dealers that either self-clear transactions or maintain custody of customer assets to allow the SEC and designated examining authorities to (1) discuss findings related to the broker-dealers’ annual audits with independent auditors and (2) review related audit documentation.

In addition, while the proposed rules would not impose an audit requirement on broker-dealers’ ICFR, certain broker-dealers would be required to (1) prepare a report on compliance with the financial responsibility rules<sup>11</sup> (the “compliance report”) and (2) obtain, from the broker-dealer’s independent certified accountant, an examination report on the compliance report; this examination report must be performed in accordance with PCAOB standards. The PCAOB also recently issued the following proposed auditing standards related to broker-dealers:

- [Examination Engagements Regarding Compliance Reports of Brokers and Dealers.](#)
- [Review Engagements Regarding Exemption Reports of Brokers and Dealers.](#)
- [Auditing Supplemental Information Accompanying Audited Financial Statements.](#)<sup>12</sup>

The SEC proposal would be effective for fiscal years ending on or after December 15, 2011, and the proposed PCAOB standards would be effective for fiscal years ending after September 15, 2012.

**Editor’s Note:** Questions have arisen about certain aspects of the broker-dealer legislation, including the interplay between the different effective dates of the SEC proposed rule and the PCAOB proposed auditing standards, assessing instances of material noncompliance (including assessing material weaknesses in controls over compliance), and various other audit-related considerations.

<sup>8</sup> SEC Proposed Rule Release No. 33-9244, *Re-proposal of Shelf Eligibility Conditions for Asset-Backed Securities and Other Additional Requests for Comment*.

<sup>9</sup> SEC Proposed Rule Release No. 34-64603, *Credit Risk Retention*.

<sup>10</sup> SEC Proposed Rule Release No. 34-64676, *Broker-Dealer Reports*.

<sup>11</sup> The proposed rule defines the financial responsibility rules, collectively, as Exchange Act rules 15c3-1, 15c3-3, 17a-13, and the Account Statement Rule. See 76 Fed. Reg. at 37,576.

<sup>12</sup> The impact of this proposed auditing standard would extend beyond broker-dealers to all companies, including those that (1) are required to provide supplemental information to regulatory bodies or (2) provide supplemental information voluntarily.

The Act calls for substantive requirements for determining that incentive-based compensation programs at certain financial service companies do not encourage excessive risk-taking.

## Additional Disclosures

One of the Dodd-Frank Act's requirements that does not seem to stem directly from the financial crisis is disclosures related to conflict minerals and to the mining and extraction industries (or "specialized disclosures"). On December 15, 2010, the SEC proposed three rules to implement three separate requirements of the Act:

1. *Mine Safety Disclosure* — Certain public companies that are coal operators, or parents of coal operators, must provide periodic reports to the SEC regarding "specified health and safety violations, orders and citations, related assessments and legal actions, and mining-related fatalities."
2. *Disclosure of Payments by Resource Extraction Issuers* — Resource extraction issuers, or entities controlled by these issuers, must disclose information pertaining to any payments "to a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals."
3. *Conflict Minerals* — Entities that use conflict minerals must disclose whether the origin of these minerals was the Democratic Republic of Congo or a surrounding country. To comply with these requirements, affected companies must furnish a separate report describing the "measures taken by [the company] to exercise due diligence on the source and chain of custody of its conflict minerals. These due diligence measures would include, but would not be limited to, an independent private sector audit of the issuer's report."

The SEC expects to issue final rules on these topics in the late summer or early fall of 2011.

**Editor's Note:** Of these three proposals, the rule on conflict minerals is the most far-reaching and thus has generated the most interest. The SEC has estimated that as many as 6,000 public companies could be affected, primarily because (1) conflict minerals have the potential to be used in various industries and (2) the SEC has proposed to include within the rule's scope both manufacturers and the companies that contract to manufacture their products, including retailers with private-label products.

## Regulation of OTC Derivatives

Title VII of the Dodd-Frank Act establishes a comprehensive framework for regulating OTC derivatives. It gives the SEC the authority to regulate "security-based swaps" and was intended to take effect on July 16, 2011, approximately one year after the Dodd-Frank Act's enactment date. Anticipating that it would not meet the Act's mandated deadlines for certain provisions under Title VII, the SEC issued three interim temporary rules on July 1, 2011, and July 7, 2011, that address clearing agencies and various aspects of security-based swaps. In addition, the SEC plans to develop a detailed plan to ensure that the Title VII regulations can be implemented efficiently and cost-effectively.

## Corporate Governance, Executive Compensation, Incentive-Based Compensation in the Financial Services Industry

The Dodd-Frank Act continues to call for certain nonbank, public financial companies and certain public bank holding companies to form a separate committee that will be responsible for risk oversight. The Act also requires the SEC to issue rules on the independence of compensation committees and advisers and calls for substantive requirements for determining that incentive-based compensation programs at certain financial service companies do not encourage excessive risk-taking.

The SEC continues to work on proposed rules and to review comments it has received on them.

## Provisions That Are Yet To Come

The SEC continues to work on proposed rules and to review comments it has received on them. In terms of upcoming rules, the Dodd-Frank Act directs the SEC to establish rules on executive compensation, including:

- Rules that would require companies to develop a policy on the recovery of incentive compensation (or “clawback”).
- Proxy statement rules that would require companies to disclose (1) a comparison of executive compensation against financial performance (pay versus performance) and (2) median total annual compensation for all employees, excluding CEO compensation, CEO annual compensation, and the ratio of CEO annual compensation to median total annual employee compensation (pay equity disclosure).
- Rules requiring proxy disclosure about whether employees and directors are allowed to hedge the value of any securities granted to them or otherwise owned by them.

In addition, the SEC plans to propose rules to define “other significant matters” related to broker voting on uninstructed shares.

**Editor’s Note:** Because implementation of the Act’s provisions and the related transition may be time-consuming and have far-reaching effects, companies are encouraged to continue to monitor rulemaking efforts and to submit comments on SEC proposals.

For additional information about the Dodd-Frank Act, see Deloitte’s Center for Corporate Governance [Web site](#). The following individuals are also available to answer questions about the Act:

- Maureen Errity — Director, Center for Corporate Governance, Deloitte LLP ([merrity@deloitte.com](mailto:merrity@deloitte.com)).
- Consuelo Hitchcock — Principal, Regulatory & Public Policy, Deloitte LLP ([chitchcock@deloitte.com](mailto:chitchcock@deloitte.com)).
- Michael Kesner — Principal, Human Capital Total Rewards, Deloitte Consulting LLP ([mkesner@deloitte.com](mailto:mkesner@deloitte.com)).

## Subscriptions

If you wish to receive *Heads Up* and other accounting publications issued by Deloitte's Accounting Standards and Communications Group, please [register](http://www.deloitte.com/us/subscriptions) at [www.deloitte.com/us/subscriptions](http://www.deloitte.com/us/subscriptions).

## *Dbriefs* for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy & tax.
- Financial reporting.
- Sustainability.
- Corporate governance.
- Financial reporting for taxes.
- Technology.
- Driving enterprise value.
- Risk intelligence.
- Transactions & business events.

*Dbriefs* also provides a convenient and flexible way to earn CPE credit — right at your desk. [Join \*Dbriefs\*](#) to receive notifications about future webcasts at [www.deloitte.com/us/dbriefs](http://www.deloitte.com/us/dbriefs).

Registration is available for this upcoming *Dbriefs* webcast. Use the link below to register:

- [Executive Compensation Update: The Public Focus Continues](#) (September 14, 2 p.m. (EDT)).

## Technical Library: The Deloitte Accounting Research Tool

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, the EITF, the AICPA, the PCAOB, the IASB, and the SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. Technical Library subscribers also receive *Technically Speaking*, the weekly publication that highlights recent additions to the library.

In addition, Technical Library subscribers have access to *Deloitte Accounting Journal* entries, which briefly summarize the newest developments in accounting standard setting.

For more information, including subscription details and an online demonstration, visit [www.deloitte.com/us/techlibrary](http://www.deloitte.com/us/techlibrary).

*Heads Up* is prepared by the National Office Accounting Standards and Communications Group of Deloitte as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.