Fallout From Dodd-Frank: Foreign Banks Sponsoring ABCP Conduits May Need to Register as Investment Advisers

One of the many federal laws affected by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") signed by President Obama on July 21, 2010 is the Investment Advisers Act of 1940 (the "IAA"). Thus far, the amendments to the IAA have not received much attention from the securitization industry, but the amendments do impose new registration and compliance requirements on certain participants in securitization transactions. In particular, foreign banks that sponsor ABCP conduits may be surprised to learn that they will become subject to these new requirements.

The IAA defines an investment adviser as a person who, for compensation, advises others as to the advisability of investing in, purchasing or selling securities. For purposes of the IAA, the term "securities" is very broadly defined and includes any note or evidence of indebtedness. Accordingly, assets purchased by an ABCP conduit would constitute "securities."

The sponsor of an ABCP conduit typically acts as administrative agent for the conduit, and selects and structures the transactions that are funded by the conduit. It appears, therefore, that the administrative agent would meet the requirements of the statutory definition of investment adviser, although there may be a question as to the compensation requirement.

Conduits have differing compensation arrangements with their agents, and there may not exist a specific fee agreement for administrative agent services. However, the bank sponsor typically receives, in one capacity or another, the bulk of the cash flow distributed by the conduit (after payment of debt service and third-party expenses such as placement agent and depository fees, audit fees, taxes, *etc.*). This cash flow may be paid out to the sponsor in its capacity as liquidity provider or as credit enhancer, or there may be a waterfall that provides that excess cash flow that is not used for any other purpose is paid to the sponsor. In view of these types of arrangements, it would seem to be difficult to argue that the administrative agent is not being compensated for its activities in selecting and structuring the conduit's assets, even if there is no express fee agreement between the conduit and the administrative agent.

The IAA requires investment advisers to register with the SEC, adopt certain compliance policies, maintain certain books and records, make public filings with the SEC, and submit to SEC examination. Currently, virtually all bank sponsors of ABCP conduits are exempt from registration under the IAA on the basis of one of two statutory exemptions. The first exemption (the "U.S. Bank Exemption") covers banks organized under the laws of the United States, member banks of the Federal Reserve System, banks or trust companies doing business under the laws of a state or the United States a substantial portion of which consists of receiving deposits or exercising fiduciary powers, and bank holding companies (as defined in the Bank Holding Company Act). The second exemption (the "Private Adviser Exemption") applies to an adviser with fewer than 15 clients in the last 12 months that does not hold itself out to the public as an investment adviser and does not advise any registered investment company. The Private Adviser Exemption is eliminated by Section 403 of the Dodd-Frank Act, effective July 21, 2011. U.S. branches of foreign banks, which have heretofore relied on the Private Adviser Exemption, and which are

not eligible for the U.S. Bank Exemption, will no longer be exempt after July 21, 2011. On the other hand, U.S. banks that sponsor conduits will continue to be exempt pursuant to the U.S. Bank Exemption.

U.S. branches of foreign banks are already subject to extensive regulation at both the state and federal levels. In fact, other provisions of the Dodd-Frank Act (*e.g.*, the definition of "banking entity" in the Volcker Rule, Section 619 of the Dodd-Frank Act) and many other U.S. banking laws (such as Section 8(a) of the International Banking Act) treat U.S. banks and U.S. branches of foreign banks similarly. There is no apparent policy reason for treating U.S. banks and U.S. branches of foreign banks differently under the IAA.

Although many provisions of the Dodd-Frank Act are subject to implementation through regulatory rulemaking, the elimination of the Private Adviser Exemption is not one of these. This leaves U.S. branches of foreign banks with two options: they can either register with the SEC as investment advisers, or seek a waiver pursuant to an SEC no-action letter or SEC interpretation. Registration is a relatively straight-forward process, and the ongoing compliance requirements under the IAA should not be unduly burdensome for a large bank that already has numerous other compliance programs in place. However, foreign banks should make a decision well in advance of the July 21, 2011 registration deadline as to how they wish to proceed, in order to ensure that compliance is implemented on time, or if they wish to seek a waiver pursuant to a no-action letter, that sufficient time is allowed to prepare a no-action letter request and to make contingent plans to register in the event the request is not granted.

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