

foreign private issuers than for accelerated filers.

## 2. Asset-Backed Issuers

In the Proposing Release, we proposed to exclude issuers of asset-backed securities from the proposed rules implementing Section 404 of the Act. We noted that because of the unique nature of asset-backed issuers, such issuers are subject to substantially different reporting requirements. Most significantly, asset-backed issuers are generally not required to file the types of financial statements that other companies must file. Also, such entities typically are passive pools of assets, without a board of directors or persons acting in a similar capacity. We did not receive any comments on the proposed exclusion of asset-backed issuers from the internal control reporting requirements, and we are excluding asset-backed issuers from the new disclosure requirements as proposed.

## 3. Small Business Issuers

Our proposed rules implementing Section 404 of the Act did not distinguish between large and small issuers. Similarly, Section 404 of the Act directs that the management report on internal control over financial reporting apply to any company filing periodic reports under Section 13(a) or 15(d) of the Exchange Act. Accordingly, these amendments apply to all issuers that file Exchange Act periodic reports, except registered investment companies, regardless of their size. However, we are sensitive that many small business issuers may experience difficulty in evaluating their internal control over financial reporting because these issuers may not have as formal or well-structured a system of internal control over financial reporting as larger companies. Accordingly, we are providing an extended compliance period for small business issuers and other companies that are not accelerated filers.<sup>105</sup> In addition, our approach of not mandating specific criteria to be used by management to evaluate a company's internal control over financial reporting should provide small issuers some flexibility in meeting these disclosure requirements.

## 4. Bank and Thrift Holding Companies

In the Proposing Release, we stated that we were coordinating with the Federal Deposit Insurance Corporation (the "FDIC") and the other federal banking regulators to eliminate, to the extent possible, any unnecessary duplication between our proposed

internal control report and the FDIC's internal control report requirements. Under regulations adopted by the FDIC implementing Section 36 of the Federal Deposit Insurance Act,<sup>106</sup> a federally insured depository institution with total assets of \$500 million or more ("institution"), is required, among other things, to prepare an annual management report that contains:

- A statement of management's responsibility for preparing the institution's annual financial statements, for establishing and maintaining an adequate internal control structure and procedures for financial reporting, and for complying with designated laws and regulations relating to safety and soundness;<sup>107</sup> and
- Management's assessment of the effectiveness of the institution's internal control structure and procedures for financial reporting as of the end of the fiscal year and the institution's compliance with the designated safety and soundness laws and regulations during the fiscal year.<sup>108</sup>

The FDIC's regulations additionally require the institution's independent accountant to examine, and attest to, management's assertions concerning the effectiveness of the institution's internal control structure and procedures for financial reporting.<sup>109</sup> The institution's management report and the accountant's attestation report must be filed with the FDIC, the institution's primary federal regulator (if other than the FDIC), and any appropriate state depository institution supervisor and must be available for public inspection.<sup>110</sup>

Although bank and thrift holding companies are not required under the FDIC's regulations to prepare these internal control reports, many of these

holding companies do so under a provision of Part 363 of the FDIC's regulations<sup>111</sup> that permits an insured depository institution that is the subsidiary of a holding company to satisfy its internal control report requirements with an internal control report of the consolidated holding company's management if:

- Services and functions comparable to those required of the subsidiary by Part 363 are provided at the holding company level;<sup>112</sup> and
- The subsidiary has, as of the beginning of its fiscal year, (i) total assets of less than \$5 billion or (ii) total assets of \$5 billion or more and a composite rating of 1 or 2 under the Uniform Financial Institutions Rating System.<sup>113</sup>

Section 404 of the Sarbanes-Oxley Act does not contain an exemption for insured depository institutions that are both subject to the FDIC's internal control report requirements and required to file Exchange Act reports. In fact, it makes no distinction whatsoever between institutions subject to the FDIC's requirements and other types of Exchange Act filers. Accordingly, regardless of whether an insured depository institution is subject to the FDIC's requirements, insured depository institutions or holding companies that are required to file periodic reports under Section 13(a) or 15(d) of the Exchange Act are subject to the internal control reporting requirements that we are adopting today.

Although our final rules are similar to the FDIC's internal control report requirements, the rules differ in a few significant respects. Most notably, our final rules do not require a statement of compliance with designated laws and regulations relating to safety and soundness. Conversely, the following

<sup>106</sup> 12 U.S.C. 1831m.

<sup>107</sup> The designated laws and regulations are federal laws and regulations concerning loans to insiders and federal and state laws and regulations concerning dividend restrictions. See 12 CFR part 363, Appendix A, Guideline 12.

<sup>108</sup> See 12 CFR 363.2, adopted in 58 FR 31332. These requirements only apply to an insured depository institution with total assets of \$500 million or more. We recognize that the FDIC's regulations use the term "internal control structure and procedures for financial reporting" rather than the term "internal control over financial reporting" used in our rules. We think the differences in the meaning of the two terms are insignificant because both Section 36(b)(2) of the Federal Deposit Insurance Act and Section 404(a) of the Sarbanes-Oxley Act refer to "internal control structure and procedures for financial reporting." Nevertheless, the FDIC has defined the term "financial reporting" to include financial statements prepared in accordance with generally accepted accounting principles ("GAAP") and those prepared for regulatory reporting purposes (see FDIC Financial Institution Letter FIL-86-94, dated December 23, 1994).

<sup>109</sup> 12 CFR 363.3.

<sup>110</sup> 12 CFR 363.4(a) and (b).

<sup>111</sup> 12 CFR Part 363.

<sup>112</sup> Services and functions are considered "comparable" if the holding company prepares and submits the management assessment of the effectiveness of the internal control structure and procedures for financial reporting and compliance with the designated safety and soundness laws and regulations based on information concerning the relevant activities and operations of those subsidiary institutions subject to Part 363. See 12 CFR Part 363, Appendix A, Guideline 4.

<sup>113</sup> This rating is more commonly known as the CAMELS rating, which addresses Capital adequacy, Asset quality, Management, Earnings, Liquidity and Sensitivity to market risk. See 12 CFR 363.1(b)(2). The appropriate federal banking agency may determine that an insured depository institution with total assets in excess of \$9 billion that is a subsidiary of a holding company may not satisfy its FDIC internal control report requirement with an internal control report of the consolidated holding company's management if the agency determines that there could be a significant risk to the affected deposit insurance fund if the institution were allowed to satisfy its requirements in this manner. See 12 CFR 363.1(b)(3).

<sup>105</sup> See Section II. J. below.