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DEVELOPMENTS OF NOTE

House Financial Services Committee Amends Consumer Financial Protection Act of 2009

As part of its financial regulatory reform program, the Obama Administration, through the Treasury, submitted to Congress proposed legislation that would establish a new consumer regulatory agency, the Consumer Financial Protection Agency (the “CFPA”), which would consolidate and expand the existing regulatory regime for consumer financial products. Rep. Barney Frank, Chairman of the House Financial Services Committee, introduced the proposed legislation to that committee as H.R. 3126, the Consumer Financial Protection Act of 2009 (the “CFPA Act”). For a further discussion of the initial draft of the CFPA Act, please see the [August 4, 2009 Alert](#).

Discussion Draft. The initial draft of the CFPA Act has been amended several times since its introduction by Chairman Frank and other members of the House Financial Services Committee. A discussion draft circulated by Chairman Frank eliminated two controversial provisions of the CFPA Act: the provisions relating to “plain vanilla” products that would have been required to be offered alongside other financial products and the “reasonableness” standard for communications with consumers.

Manager’s Amendment. A manager’s amendment offered by Chairman Frank (the “Manager’s Amendment”) included many revisions to the draft language of the CFPA Act. The Manager’s Amendment excludes the Treasury and any person collecting federal taxes from the definition of covered person. It also provides that certain activities would not be considered engaging in a “financial activity,” such as the publication of newspapers and other financial publications of general and regular circulation, advice relating to U.S. backed obligations and exempted securities under the Securities Exchange Act of 1934, and

the sale of stored value cards unless the seller influences the terms or conditions of the stored value card. An issuer of stored value cards would still be covered under the CFPA Act. The Manager's Amendment excludes from the definition of "financial services" investment advice by registered investment advisers and tax preparation services. The CFPA would not have regulatory or supervisory authority over providers of tax preparation services and such services would be allowed to provide credit to customers. However, tax planning services other than tax preparation services would fall within the definition of financial services. Attorneys, to the extent they are engaged in the practice of law; accountants, unless providing an extension of credit or sale of securities; and the Federal Home Loan Banks are also excluded from the jurisdiction of the CFPA.

The Manager's Amendment provides that a third party service provider is a "covered person" under the CFPA Act if the service provider: (i) provides for the marketing, solicitation, disclosure, delivery, account maintenance or loan servicing for a financial product or service sold to consumers; (ii) serves as the primary point of contact for resolving consumer questions or complaints; or (iii) is determined by the CFPA to have a significant impact on the price, terms, or conditions of the financial product or service sold to consumers. Processing transactions or transmitting funds or data that does not involve correspondence with consumers would not result in the service provider becoming a "covered person." However, "account maintenance" would result in coverage, even if the company providing such services has no contact with consumers.

The Manager's Amendment adds a new section regarding "remittance transfers" and remittance transfer providers. A remittance transfer is the electronic transfer of funds at the request of a customer located in the U.S. to a person in another country. A remittance transfer provider is any person, including depository institutions, that originates a remittance transfer in the normal course of business. Among other things, a remittance transfer provider must comply with new rules requiring disclosures in English and foreign languages, rights to cancel a transaction, error resolution procedures, and the provision of a toll free number and web access.

The Manager's Amendment clarifies that examinations of "covered persons" by the CFPA are only with respect to consumer financial products and services and that the CFPA has primary enforcement authority with respect to any federal law for which both the CFPA and Federal Trade Commission have jurisdiction. The Manager's Amendment provides that any federal agency may recommend that the CFPA take an enforcement action; if the CFPA does not act within 120 days, then the referring federal agency may bring its own action. The Manager's Amendment further provides that the CFPA must consult with other federal and state agencies regarding the consistency of proposed regulations. However, the CFPA is not required to modify any proposed regulation as a result of such consultations. The Manager's Amendment preserves the rights of state securities and insurance regulators to adopt rules, initiate enforcement actions or take other actions with respect to a person under their jurisdiction.

Merchant Exclusions. The CFPA Act was also revised to exclude certain activities of merchants, retailers and sellers of nonfinancial products from the regulatory and supervisory authority of the CFPA. In particular, the amended language provides that the CFPA shall not exercise authority over credit extended directly by a merchant for the purchase of goods or services that are not a financial product or service or the collection of the debt arising from such credit. However, a merchant would be covered if he or she provides any other financial service or product. For example, a merchant that offers customers a "lay away" option is covered, since the merchant would be holding customer

funds in a custodial capacity, which is defined as a financial service. The amendment does not affect the authority of the FTC and other agencies. The exclusion does not apply if the merchant assigns or sells the debt to another person, the credit provided exceeds the market value of the product or service provided or the CFPA finds that the sale of the product is a subterfuge to evade the provisions of the Act.

Examination Authority. The House Financial Services Committee has approved an amendment which provides that banks with \$10 billion or less in assets and credit unions with \$1.5 billion or less in assets would be examined by their primary federal regulator for compliance with CFPA rules rather than by CFPA examiners. The federal banking agencies would also have primary enforcement authority of CFPA regulations for financial institutions of that size. However, all financial institutions would be subject to the CFPA's rules and regulations and the CFPA would continue to have back-up enforcement and examination powers.

Other Amendments. The House Financial Services Committee has approved two other amendments to the CFPA Act. One amendment exempts retail agents or brokers for sales of manufactured homes or modular homes from CFPA regulation and oversight. The other amendment requires the CFPA to provide on its website a disclaimer saying it does not endorse particular products or services.

Preemption. The CFPA Act currently eliminates federal preemption of state consumer protection statutes. The House Financial Services Committee is scheduled consider amendments which would address the possibility of retaining federal preemption, possibly with a limited scope.

Basel Committee Analyzes Impact of Trading Book Reforms

The Basel Committee on Banking Supervision (the "BCBS") announced the results of a quantitative impact study (the "Study") regarding proposed revisions (the "Proposed Revisions") to Basel II's market risk framework. The Proposed Revisions were published in January 2009 and subsequently adopted by the BCBS in July 2009. (Please see the [July 21, 2009 Alert](#) for details regarding the Proposed Revisions.) The Study concluded that the Proposed Revisions will increase average trading book capital requirements by two to three times their current levels when they take effect at the end of 2010. More specifically, the Study found that banks on average will have to increase their overall capital by at least 11.5%, and that capital requirements specifically allocated to cover market risks will increase by almost 224% on average. In addition, the Study states that the actual change in minimum capital requirements will likely be higher because the overall average includes banks which did not report data on all aspects of the upcoming revisions. Importantly, the BCBS also noted that the results showed "significant dispersion" among banks around the average increase. The range of overall capital increase from the Proposed Revisions ranged from -0.4% to 85%, while the range for market risk capital increase ranged from -19.5% to almost 1,113%. Based on the results of the Study, the BCBS decided to maintain the "original calibration" of the Proposed Revisions.

The Study, which included data from 43 banks across 10 countries, assessed the impact of: (1) the capital charge for incremental risk; (2) the stressed value-at-risk (VaR) capital charge; (3) the capital charges for securitization exposures in the trading book; and (4) the revised specific risk capital charge for certain equity exposures under the standardized measurement method. Due to the timing of the Study, it did not reflect the changes

regarding the treatment of banks' correlation trading activities. Instead, the BCBS will conduct an impact study in 2010 which will focus on correlation trading activities.

The U.S. banking agencies have not yet finalized revisions to the market risk rules, but have indicated that they are working on their development. The process of revising the market risk rules began several years ago and the agencies had previously indicated that a final rule would be issued in the near future. Seemingly, the financial crisis has been a significant cause of the delay.

SEC Issues Formal Releases for Recent Rulemaking Affecting Credit Rating Agency Regulation and Use of Credit Ratings in SEC Rules

On October 5, 2009, the SEC issued formal releases adopting formal rules and reopening the comment period for other existing proposals that modify its rules regulating credit rating agencies. In addition, on October 7, 2009, the SEC issued a release proposing rules that deal with credit rating disclosures in connection with registered offerings and also issued a concept release regarding enhanced potential liability for ratings agencies. The SEC's rules apply to credit rating agencies registered as Nationally Recognized Statistical Rating Organizations ("NRSROs"). The recently issued releases are briefly described below.

Final Rules - References to credit ratings in SEC rules and forms. The SEC issued a [formal release](#) (the "Adopting Release") adopting amendments that eliminate references to NRSRO credit ratings in certain SEC rules under the Securities Exchange Act of 1934, as amended (the "1934 Act"), and the Investment Company Act of 1940, as amended (the "1940 Act"). Among the provisions affected are (i) the look-through provisions of Rule 5b-3 under the 1940 Act, and (ii) the ratings requirements for municipal bonds a fund purchases in reliance on Rule 10f-3 under the 1940 Act. These amendments become effective on November 12, 2009.

Rule 5b-3 allows an investment company (a "fund") to treat a refunded bond it acquires as the U.S. government securities that refund the payments due to investors under the bond. A "refunded security" is a debt security whose principal and interest payments are to be paid by U.S. government securities that have been irrevocably placed in an escrow account and are pledged only to the payment of the debt security. Rule 5b-3 allows a fund that meets certain conditions to treat the refunded security as an acquisition of the escrowed government securities for the purposes of the 1940 Act's requirements for a diversified fund. Currently, these conditions include a requirement that either (a) a certified public accountant has certified to the escrow agent that the escrowed securities will satisfy the scheduled payments on the refunded securities, or (b) the refunded security has received a sufficiently high debt rating from an NRSRO. As amended, Rule 5b-3 will require an independent accountant certification for all refunded securities, regardless of their debt rating.

Rule 10f-3 allows a fund to purchase securities in an underwritten offering in which a fund affiliate is a member of the underwriting syndicate if certain requirements are met. Currently, municipal securities may be purchased under the Rule if the securities have an investment grade rating from at least one NRSRO. Under amended Rule 10f-3, references to NRSRO ratings will be eliminated and replaced with alternate provisions that will require that the securities be sufficiently liquid that they can be sold at or near their carrying value within a reasonably short period of time and are either (i) subject to no greater than moderate credit risk or (ii) in the case of issuers who have not been in continuous operation for three years, subject to minimal credit risk. The Adopting Release indicates that in

developing the procedures required under the Rule, a fund's board of directors may use ratings, reports, analyses, opinions and other assessments issued by third-parties, including NRSROs, "although an NRSRO rating, by itself could not substitute for the evaluation performed by the board." The SEC would expect a fund board to evaluate assessments it intends to use and the third-party sources that provide them.

Proposed Rules - References to credit ratings in SEC rules and forms. The SEC issued a [formal release](#) reopening the comment period on certain existing proposed rule changes that would eliminate references to NRSROs in other rules and forms under the 1934 Act, the 1940 Act, the Investment Advisers Act of 1940, as amended, and the Securities Act of 1933, as amended (the "1933 Act"). Comments on these proposed rules are due by December 8, 2009.

Proposed Rules - Ratings information in registered offerings. The SEC issued a [formal release](#) proposing new rules that would require an issuer (including closed-end investment companies but not open-end investment companies) in a registered offering that uses a credit rating with respect to the issuer or any class of its securities, to include certain disclosures relating to each such credit rating in the prospectus for the offering. These disclosures would include the material limitations of the credit rating, information about the rating agency's rating system, the source of payment for the credit rating, and any preliminary ratings not used by the a registrant. The proposal would also require an issuer (including a closed-end investment company) to file a Form 8-K if the issuer was subsequently notified of a change or withdrawal of such credit rating. Comments on these proposed rules are due by December 14, 2009.

Concept Release- Elimination of exemptions for NRSRO registration statement consents and liability. The SEC issued a [concept release](#) seeking public comment on whether to eliminate Rule 436(g) under the 1933 Act. Rule 436(g) currently provides that a credit rating is not considered a part of an issuer's registration statement prepared or certified by a person within the meaning of (a) Section 7 of the 1933 Act, which, in general terms, requires an issuer's registration statement to include the consent of an expert cited in the registration statement, and (b) Section 11 of the 1933 Act, which addresses liability for a false registration statement. Comments on the concept release are due December 14, 2009. If the SEC rescinds Rule 436(g), an issuer who uses a credit rating assigned by an NRSRO in connection with a registered offering would be required to file the NRSRO's consent as an exhibit to its registration statement, and as a result, the NRSRO would be subject to potential liability under Section 11 of the 1933 Act.

The SEC has not issued a formal release describing the remaining rule proposal discussed at the September 17, 2009 meeting. This proposal would require an NRSRO to (i) provide the SEC with a report on its compliance reviews for the most recently ended fiscal year, (ii) disclose the percentage of its net revenue attributable to the 20 largest users of its credit rating services and the percentage of its net revenue attributable to other services and products it provides, and (iii) make publicly available information about each person that paid for a credit rating in a consolidated report posted on the NRSRO's website at the end of each fiscal year and provide the web address for this information whenever the NRSRO publishes a credit rating.

SEC and CFTC Issue Joint Report on Harmonization of Regulation

The Treasury's White Paper on Financial Regulatory Reform, released on June 17, 2009 (the "White Paper") (as discussed in the [June 23, 2009 Alert](#)), recommended that the CFTC

and the SEC identify “all existing conflicts in statutes and regulations with respect to similar types of financial instruments and either explain why those differences are essential to achieve underlying policy objectives with respect to investor protection, market integrity, and price transparency or make recommendations for changes to statutes and regulations that would eliminate the differences.” In response, the SEC and CFTC held joint meetings on September 2 and 3, 2009 to hear from the public on regulatory harmonization and issued on October 16, 2009 “[A Joint Report of the SEC and the CFTC on Harmonization of Regulation](#)” (the “Report”). The Report touches on a number of issues and focuses on: “(i) product listing and approval; (ii) exchange/clearinghouse rule changes; (iii) risk-based portfolio margining and bankruptcy/insolvency regimes; (iv) linked national market and common clearing versus separate markets and exchange-directed clearing; (v) price manipulation and insider trading; (vi) customer protection standards applicable to financial advisers; (vii) regulatory compliance by dual registrants; and (viii) cross-border regulatory matters.”

In discussing variances between the two regulators, their authority and jurisdictions, and the regimes they oversee, the Report emphasizes the difference between the securities markets and their role in capital formation and the futures markets’ primary purpose of transferring risk and facilitating the management of positions in assets of limited supply. The Report also cites the rapid development of the derivatives industry as a source of significant regulatory gaps in the securities and futures markets. Highlights of the Report’s recommendations to address these regulatory gaps include the following.

Enhancement of CFTC Jurisdiction and Authority. A theme throughout the Report is the need to extend and enhance the CFTC’s jurisdiction and authority, including enhanced authority over exchange and clearinghouse compliance with the Commodity Exchange Act (the “CEA”), as well as preventing conflicts of interest. Although each of the SEC and CFTC enforces similar laws prohibiting market manipulation, insider trading and fraud, the Report calls for strengthening each agency’s enforcement authority in certain areas and, particularly, the CFTC’s enforcement authority with respect to “disruptive trading practices.” The Report also recommends expanding the scope of insider trading prohibitions under the CEA.

Markets and Clearing Systems. In the Report, the SEC and CFTC do not propose specific reforms to address the issues highlighted in the Report resulting from market linkage and the different clearing models used in the securities and futures markets. Noting that the SEC oversees a national market of linked execution platforms and exchanges, while futures exchanges operate independently, the Report eschews recommendations to harmonize regulation of these different markets and systems. The Report does note that certain public commentary received by the SEC and CFTC favored increased fungibility for futures contracts.

Regulatory Scheme. The Report includes a number of recommendations for harmonizing the activities of the SEC and the CFTC. First is a new platform for discussion of regulatory issues affecting the two agencies, namely a Joint Advisory Committee “that would be tasked with considering and developing solutions to emerging and ongoing issues of common interest in the futures and securities markets.” The SEC and CFTC also recommend a Joint Agency Enforcement Task Force “to harness synergies from shares market surveillance data, improve market oversight, enhance enforcement, and relieve duplicative regulatory burdens” and a Joint Information Technology Task Force to “pursue linking information on CFTC and SEC regulated persons made available to the public and such other information [the SEC and CFTC] jointly find useful and appropriate in the public

interest.” The Report also promotes a joint cross-agency training program for the SEC and CFTC staff, as well as a program for the regular sharing of staff through detail assignments.

Dispute Resolution Mechanism. In the Report the agencies recognize a need for a jurisdictional dispute resolution mechanism. Despite previous efforts to coordinate new product approvals, including a Memorandum of Understanding that the SEC and CFTC entered into in 2008 to coordinate “[p]roposals to list or trade novel derivative products,” the two agencies continue to face an inability to promptly resolve jurisdictional issues, according to the Report.

Financial Intermediaries. The Report emphasizes the importance of applying consistent standards for financial advisers, including broker-dealers and investment advisers, in order to avoid confusion in the market. This position is in accord with the position in the Treasury’s proposed legislation, Over-the-Counter Derivatives Markets Act of 2009, that there be a uniform fiduciary duty standard of conduct for persons providing similar investment advisory services. The Report also recommends efforts to work together to minimize burdens on market participants with respect to dual registration and that the registration, reporting and recordkeeping regimes of the two agencies are generally similar.

Margins. The SEC and CFTC in the Report recommend legislation to modify portfolio margining in the context of enhancing consumer protection. The Report also includes consideration of a single account margin account model to accommodate margining of portfolios that include securities and futures.

Cross-Border Trading. The Report addresses in general terms regulation of cross-border activities, including registration, reporting and other requirements of non-U.S. products, exchanges and clearing agencies. The Report also includes more specific recommendations for addressing cross-border trading and non-U.S. markets. For example, the SEC would review its practices and undertake to implement modifications aimed at greater efficiency for cross-border transactions, and the Report recommends giving the CFTC authority to regulate foreign boards of trade.

FinCEN Issues Advisory on Filing SARs Regarding TARP-Related Programs

The Financial Crimes Enforcement Network (“FinCEN”) issued an [advisory](#) (the “Advisory”) to assist financial institutions in identifying and reporting activities related to the U.S. government’s Troubled Asset Relief Program (“TARP”) that could trigger an obligation to file a suspicious activity report (“SAR”). In the Advisory, FinCEN explains that TARP-related programs provide substantial funds to a range of financial institutions and their customers, and, therefore, are susceptible to various forms of fraud, money laundering and other financial crimes.

FinCEN generally observes that the trends and indicators of potential suspicious activity involving TARP funding are similar to the trends and patterns that financial institutions encounter in monitoring non TARP-related transactions. Accordingly, FinCEN states that financial institutions should be able to use their existing customer identification and anti-money laundering programs in (1) identifying customers who qualify for TARP-related funding, (2) anticipating the types of TARP-related transactions that such customers may conduct, and (3) identifying suspicious activity by such customers. Financial institutions also are instructed to take advantage of public information in identifying transactions that might involve a TARP-related entity, such as wire instructions involving Capital Purchase

Program (“CPP”)-funded banks or Public Private Investment Program (“PPIP”) fund managers.

The Advisory provides a list of activities that may indicate suspicious activity in TARP-related transactions, which a financial institution should consider in light of its business plan, operations, customers and customer transactions to determine whether a SAR filing is warranted. These activities are the following:

- *Conflicts of Interest.* The Advisory observes that some TARP-related programs, such as the PPIP, are structured to benefit service providers, and that an increase in the price of a mortgage-backed asset will likely benefit a party which owns or manages the asset, potentially including the PPIP manager making investment decisions. For example, suspicious activity may be present if a financial institution observes multiple transactions over a short-time period (*e.g.*, “flipping”) that result in a rapid increase in the valuation in otherwise stagnant product or geographical markets.
- *Collusion.* The Advisory notes that PPIP fund managers could be persuaded, through kickbacks, *quid pro quo* transactions, or other collusive arrangements to manage PPIPs for personal gain rather than for the benefit of the PPIP. Potential indicators of illegal collusion identified by FinCEN are (1) anomalous or out-of-market pricing of assets in seemingly arm’s-length transactions among affiliates or (2) the appearance of nominee or front individuals in transactions.
- *Insider Trading.* The Advisory states that federal government involvement and the substantial investment of TARP-related funds in existing markets present an opportunity for insiders to benefit before TARP-related transaction is publicly disclosed. A red flag that suspicious insider trading is being conducted could be a spike in the volume of trading in a CPP-funded public company just before a public announcement regarding its receipt, use or repayment of TARP-related funds.
- *Advance Fee Schemes.* The Advisory refers to April 2009 [guidance](#) regarding filing SARs related to loan modification/foreclosure scams in the context of residential mortgages. In that guidance, FinCEN provided a list red flags to watch for when receiving information from customers or other parties that may indicate the presence of a foreclosure rescue scam.
- *Money Laundering.* The Advisory also urges financial institutions to look for money laundering activities involving TARP-related funds, which might closely resemble traditional money laundering transactions but would involve TARP funds or the trading of mortgage-backed securities.

If a financial institution determines that a SAR filing is warranted in connection with TARP-related funds or activities, the Advisory instructs the financial institution to check the appropriate box on the SAR form regarding the type of suspicious activity and to include the term “SIGTARP” in the narrative portion of the SAR. In addition, the Suspect/Subject Information Section of the SAR should be completed to include all available information regarding each suspect, including individual or company name, address, phone number and any other identifying information.

SEC Proposes Amendments to Rule Requiring Internet Availability of Proxy Materials

The SEC voted to propose amendments to Rule 14a-16 under the Securities Exchange Act of 1934 (the “Rule”) which requires that proxy materials be made available on the internet and that shareholders receive notice regarding the availability of those materials (the “Notice”). (For more detail on these requirements, see the [July 31, 2007 Alert](#).) When distributing proxy materials, issuers generally have two options: (i) send only the Notice to shareholders or a subset of shareholders (the “Notice Only Method”) or (ii) use the traditional method of mailing full proxy materials, along with or including a Notice, to shareholders or a subset of shareholders (the “Traditional Method”). The proposed amendments are designed to facilitate the response of shareholders who have received a Notice under the Notice Only Method.

Shareholder Response to the Notice Only Method in the 2009 Proxy Season. The release proposing the changes (the “Proposing Release”) cites the results of a third-party survey of response rates in the 2009 proxy season for corporate issuers that used the Notice Only Method for some of their shareholder base versus those for issuers that used the Traditional Method exclusively. Among other findings, the survey indicated that when issuers used the Notice Only Method for some shareholders and the Traditional Method for other shareholders, the response rate of retail (non-institutional) shareholders receiving only the Notice was half that of retail shareholders receiving the full set of materials. While not concluding that any aspect of the Notice Only Method is reducing shareholder response rates, the Proposing Release indicates that the proposed amendments are designed to remove regulatory impediments that may be reducing shareholder proxy response rates.

Proposed Changes. In summary, the proposed amendments would, among other things:

- provide additional flexibility regarding the format of the Notice by eliminating the Rule’s specific legend requirements while still requiring that the information appearing on the Notice address the same topics;
- allow proxy issuers to accompany the Notice with an explanation of the Notice Only Method, which would be limited to addressing the process of receiving or reviewing the proxy materials and voting;
- expand the types of documents a mutual fund may provide with a Notice to include the mutual fund summary prospectus; and
- allow a non-issuer soliciting person to file a preliminary proxy statement 10 days after the issuer files its definitive proxy statement and send its Notice to shareholders no later than the date on which it files its definitive proxy statement with the SEC.

Identification of Matters to be Acted On. The Proposing Release also notes that issuers are not required to follow the formatting and content requirements of Rule 14a-4, which governs proxy cards, when identifying in the Notice each separate matter to be acted on at the meeting. Identification of each matter to be considered at the meeting “(e.g., election of directors; ratification of auditors; approval of a stock option plan, etc.)” is sufficient.

Public Comment. Comments on the proposed amendments are due no later than November 20, 2009.

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OTHER ITEM OF NOTE

Goodwin Procter Issues Client Alert on Revised Private Fund Adviser Registration Legislation with Exemption for Advisers to “Venture Capital Funds”

Goodwin Procter’s Private Investment Funds Practice issued a [Client Alert](#) discussing recent draft legislation that is nearly identical to proposed private fund adviser registration legislation released by the Obama administration in July (see the [July 21, 2009 Alert](#)), except that the more recent legislation would exempt any adviser to a “venture capital fund” from its registration requirements.