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EDITORS

Eric R. Fischer

Jackson B.R. Galloway

Elizabeth Shea Fries

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DEVELOPMENTS OF NOTE

SEC Adopts Additional Compensation and Corporate Governance Disclosure Requirements for Public Companies and Registered Funds

The SEC issued the [formal release](#) describing rule and form amendments adopted at its open meeting on December 16, 2009 that (a) expand compensation disclosure requirements for operating companies, (b) impose new corporate governance disclosure requirements on operating companies and registered management investment companies (“funds”) and (c) modify the manner and timing of disclosure of shareholder voting results for operating companies. This article focuses on changes specific to funds, which will require additional disclosure regarding (i) director and nominee qualifications; (ii) past directorships held by directors and nominees; (iii) legal proceedings involving directors, nominees, and executive officers to funds; (iv) board leadership structure and the board’s role in the oversight of risk; and (v) nominating committee consideration of diversity in selecting nominees. The SEC deferred action on amendments to its proxy solicitation rules proposed in connection with the adopted amendments, pending consideration of its proposal regarding shareholder nomination of directors. (On December 14, 2009, the SEC reopened comment on its shareholder nomination proposal (as discussed in the [December 15, 2009 Alert](#)).)

Goodwin Procter’s Securities & Corporate Finance and ERISA & Executive Compensation Practices have issued a [Public Company Advisory](#) that discusses how these new disclosure requirements apply to public companies. The SEC staff has provided subsequent [guidance](#) on how the new requirements become effective for public companies.

Director and Nominee Disclosure. Under the amendments, a fund must disclose for each director and any nominee for director the particular experience, qualifications, attributes or skills that led the board to conclude that the person should serve as a director for the company, in light of the fund's business and structure, as of the time that the filing containing this disclosure is made with the SEC. The amendments do not specify the particular information that should be disclosed but do indicate that, if material, this disclosure should cover more than the past five years, including information about the person's particular areas of expertise or other relevant qualifications. These same requirements will apply to any nominees put forward by other proponents. The new disclosure will be required for all nominees and for all directors, including those not up for reelection in a particular year. Also, under the amendments, a fund must disclose for each director and any director nominee any directorships at public companies (including registered investment companies) held during the past five years, even if the position is no longer held. In proxy and information statements, the period examined to determine whether a director, executive officer or director nominee was involved in specified legal proceedings will be expanded from 5 to 10 years. Except for the disclosure requirement regarding legal proceedings, the foregoing disclosure requirements will apply to funds in proxy and information statements regarding director elections and in SAIs for registration statements on Forms N-1A, N-2 and N-3.

Leadership Structure and Board Role in Risk Management. A fund will be required to describe its leadership structure, including the board's responsibilities with respect to the fund's management. It must also identify whether the chairman of its board is an interested person, and if so, whether the fund has a lead independent director and what specific role the lead independent director plays in the fund's leadership. This disclosure must indicate why the fund has determined that its leadership structure is appropriate given the fund's specific characteristics or circumstances. Finally, a fund must disclose the extent of the board's role in risk oversight, such as how the board administers its oversight function and its effect on the board's leadership structure. The SEC release describing the new disclosure requirements notes that "[f]unds face a number of risks, including investment risk, compliance, and valuation," and that "this disclosure should provide important information to investors about how a fund perceives the role of its board and the relationship between the board and its advisor in managing material risks facing the fund." The foregoing disclosure requirements will apply to funds in proxy and information statements regarding director elections and in statements of additional information for registration statements on Forms N-1A, N-2 and N-3.

Nominating Committee Consideration of Diversity. Currently, proxy and information statements relating to director elections must describe a nominating committee's process for identifying and evaluating director nominees. Under the amendments, a fund must also disclose whether, and if so how, its nominating committee considers diversity in identifying nominees for director. If the nominating committee has a policy regarding the consideration of diversity in identifying director nominees, the proxy or information statement must describe how this policy is implemented, as well as how the nominating committee assesses the effectiveness of its policy. The amendments do not define "diversity." In the release describing the amendments, the SEC states that it recognizes that issuers "may define diversity in various ways, reflecting different perspectives. For instance, some [issuers] may conceptualize diversity expansively to include differences of viewpoint, professional experience, education, skill and other individual qualities and attributes that contribute to board heterogeneity, while others may focus on diversity concepts such as race, gender and national origin. We believe that for purposes of this

disclosure requirement, [issuers] should be allowed to define diversity in ways that they consider appropriate.”

Effective Date. The effective date for the disclosure amendments is February 28, 2010.

FDIC Issues Advance Notice of Proposed Rulemaking Regarding Safe Harbor for Bank-Sponsored Securitizations

On December 15, 2009 the FDIC issued an Advance Notice of Proposed Rulemaking (the “ANPR”) seeking comments regarding proposed revisions to the safe harbor provided at 12 C.F.R. §360.6 (the “Safe Harbor”) from the FDIC’s ability, as conservator or receiver, to recover assets securitized or participated out by a federally insured depository institution (an “IDI”) and to impose a stay on the ability of third parties to enforce contracts with the IDI.

Revisions to the Safe Harbor became necessary because changes to the generally accepted accounting principles’ (“GAAP”) “true sale” accounting rules threatened the effectiveness and legal certainty of the Safe Harbor. Specifically, FAS No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140 (“FAS 166”) and FAS No. 167, Amendments to FASB Interpretation No. 46(R) (“FAS 167”) are effective for reporting periods which begin after November 15, 2009. (For more information on FAS 166 and FAS 167, see the [June 16, 2009 Alert](#).) In response, the FDIC issued on November 13, 2009 an interim rule (the “Interim Rule”) continuing on a transitional basis the Safe Harbor, which affords protections to transactions that had complied with the Safe Harbor under the prior accounting rules and is set to expire on March 31, 2010. (For more information on the Interim Rule and the need for revisions to the Safe Harbor, see the [November 17, 2009 Alert](#).) The ANPR is intended to result in a permanent solution to the issues raised by the accounting rules changes and also to address recent performance issues in securitizations and, in particular, securitizations that include residential mortgage assets in their collateral pools.

The FDIC had originally indicated its intent to issue a Notice of Proposed Rulemaking (“NPR”) (as opposed to the ANPR) regarding proposed revisions to the Safe Harbor on December 15, 2009. However, two members of the FDIC’s Board of Directors, Comptroller of the Currency John Dugan and OTS Acting Director John Bowman, did not support issuing an NPR, taking the position that the planned proposal could hurt the securitization market and put banks at a competitive disadvantage. Comptroller Dugan and Acting Director Bowman also have noted that the proposal could conflict with legislation currently being contemplated by Congress. Accordingly, the FDIC issued the ANPR, which is not a formal rulemaking proposal and does not represent the FDIC’s formal position on these issues.

In the ANPR, the FDIC states its support for sustainable securitization to provide balance sheet liquidity and, where appropriate, off balance sheet transactions that enhance prudent credit availability. However, the FDIC also states in the ANPR that the defects in many subprime and other mortgages originated and sold into securitizations requires attention by the FDIC to fulfill its responsibilities as deposit insurer and receiver.

The ANPR poses 35 wide ranging questions about the impact of proposed revisions to the Safe Harbor. These questions cover various issues related to securitizations, including: (1) capital structure; (2) disclosure; (3) documentation and recordkeeping;

(4) compensation; and (5) origination and retention requirements. These questions also seek comment on whether there should be changes to the Safe Harbor to address the impact of FAS 166 and FAS 167 on participations and whether it would be appropriate to make the conditions applicable to residential mortgage-backed loan securitizations (“RMBS”) more stringent than those applicable to other types of securitizations. Furthermore, the FDIC questions in the ANPR whether the general transition period extending to March 31, 2010 is sufficient.

In order to provide a basis for consideration of the ANPR’s questions and other considerations in revising the Safe Harbor, the ANPR includes a draft of sample regulatory text that would replace the Safe Harbor. This sample regulatory text, which the ANPR notes is *not* a proposal, addresses separately participations, securitizations that meet the new true sale requirements under the accounting guidelines, and securitizations that do not meet such new requirements. Highlights of the sample regulation include the following.

- With respect to participations, the FDIC is not proposing any changes to the Safe Harbor. This would have the effect of excluding all participations that do not meet GAAP true sale requirements under FAS 166 and FAS 167.
- With respect to all securitizations, regardless of whether they meet GAAP true sale requirements, the sample regulation proposes to clarify that the FDIC, acting as conservator or as receiver, would consent to regularly scheduled payments to investors in all covered securitizations, thereby negating any effect of the FDIC stay.
- Covered securitizations that meet GAAP true sale requirements would be within the sample regulation’s safe harbor and the FDIC would not, in the exercise of its statutory authority to disaffirm or repudiate contracts, reclaim, recover, or recharacterize as property of the IDI or the receivership such transferred financial assets.
- With respect to covered securitizations that do not meet GAAP true sale requirements but meet the sample regulation’s other requirements, the new regime would afford limited relief.
 - Following a monetary default for at least ten business days after the delivery of a written request, the FDIC would consent to the exercise of contractual rights afforded a third party.
 - If the FDIC, acting as receiver or conservator, repudiates the securitization agreements of a covered securitization and does not pay damages as required by the Federal Deposit Insurance Act within ten days of such repudiation, the FDIC would consent to the exercise of any contractual rights afforded a third party.
- In order to qualify as a covered securitization, a securitization would have to meet a stringent set of requirements, including: (1) the sponsor would be required to retain at least 5% of the asset pool’s credit risk, which may not be transferred or hedged during the term of the securitization; (2) not be a re-securitization (except in limited circumstances), or an unfunded or synthetic securitization; (3) have cash flows that are based primarily on the performance of the underlying financial assets and not contingent on market or independent credit events; (4) comply with new disclosure requirements, including Regulation AB regardless of whether publicly issued or not;

and (5) comply with structure compensation and documentation requirements under the new regime.

Interested parties will have 45 days following the ANPR's publication in the *Federal Register* to provide comments on the ANPR to the FDIC.

FDIC Approves Final Rule on Risk-Based Capital Guidelines Related to Adoption of FAS Nos. 166 and 167

The Board of Directors of the FDIC approved a joint interagency final rule (the "Final Rule") amending the federal banking agencies' (the "Agencies") general risk-based capital standards and the advanced risk-based capital adequacy framework (together, the "Risk-Based Capital Guidelines") in recognition of the regulatory capital impact related to the implementation of Financial Accounting Standards Board's Statement of Financial Accounting Standards Nos. 166 and 167 ("FAS Nos. 166 and 167"). For further discussion of FAS Nos. 166 and 167, please see the [June 16, 2009 Alert](#), and for additional information on the notice of proposed rulemaking related to the Final Rule (the "NPR"), please see the [September 1, 2009 Alert](#).

The Final Rule permits a banking institution to phase in implementation of FAS Nos. 166 and 167 for purposes of the Risk-Based Capital Guidelines. More specifically, the Final Rule provides for an optional two-quarter implementation delay followed by an optional two-quarter partial implementation of the effect on risk-weighted assets that will result from changes to U.S. generally accepted accounting principles ("GAAP") from FAS Nos. 166 and 167. The Final Rule also permits banking organizations to include in Tier 2 capital for purposes of the first two regulatory reporting periods following the implementation of FAS Nos. 166 and 167 any increase in the allowance for loan and lease losses ("ALLL") attributable to assets consolidated under the requirements of FAS Nos. 166 and 167, followed by a two-quarter phase-in of the regulatory restriction on the amount of such ALLL that may be included in Tier 2 capital. (Generally, the Risk-Based Capital Guidelines limit the inclusion of ALLL in Tier 2 capital to 1.25% of risk-weighted assets.) These delays and transitions apply only to the requirements under the Risk-Based Capital Guidelines, however, and not also to the leverage capital ratio. Furthermore, there is no relief with respect to variable interest entities to which banks have provided implicit or voluntary support.

Consistent with the NPR, the Final Rule also eliminates the exclusion of certain consolidated asset-backed commercial paper (ABCP) programs from risk-weighted assets, subject to the delays and transitions described above. In addition, the Final Rule includes the NPR's reservation of authority permitting the federal banking agencies to require banking organizations to treat entities that are not consolidated under GAAP as if they were consolidated for risk-based capital purposes if the banking organization's exposure or other relationship to the entity is not commensurate with the actual risk relationship of the banking organization to the entity.

The FRB, OCC and OTS are expected to approve the Final Rule soon. The Final Rule will become effective 60 days after its publication by the Agencies in the *Federal Register*.

Foreign Bank Agrees to \$536 Million Fine for OFAC Violations

A large foreign banking institution, Credit Suisse AG (the “Bank”), agreed to pay \$536 million to settle apparent violations of sanctions regulations administered by the U.S. Treasury Department’s Office of Foreign Assets Control (“OFAC”). The fine is the largest sanctions penalty assessed by OFAC to date, and is part of a global settlement that also involves the U.S. Department of Justice and the New York County District Attorney’s office. In addition to the fines, the Bank agreed to the filing of a criminal information in the U.S. District Court for the District of Columbia charging the Bank with violating the International Emergency Economic Powers Act (“IEEPA”) and accepted and acknowledged criminal responsibility for its conduct. As explained below, the Bank also consented to the issuance of a Cease and Desist Order (the “C&D Order”) by the FRB.

As asserted by OFAC in its [press release](#) and in its [Settlement Agreement](#) with the Bank, for more than 20 years the Bank engaged in the practice, in connection with payment transactions routed to or through the United States, of stripping or changing information in wire transfer instructions regarding the identities of the actual originators or beneficiaries of the transactions. For transactions totaling hundreds of millions of dollars, the actual originators or beneficiaries were Specially Designated Nationals, or parties from or located in Iran, Cuba, Sudan or other OFAC-sanctioned jurisdictions, making the transactions prohibited under OFAC sanctions regimes. The Bank also instructed its Iranian clients to falsify wire transfer instructions to enable the transactions to pass undetected through the U.S. financial system. In furtherance of these practices, the Bank developed internal procedural guidelines and trained employees to structure transactions to avoid disclosing the involvement of OFAC-sanctioned parties and jurisdictions. These actions were discovered by the Bank and halted internally in 2006, and the Bank then voluntarily disclosed the issue to OFAC.

The severity of the penalty assessed to the Bank reflects OFAC’s determination under its recently finalized enforcement guidelines (see the [December 1, 2009 Alert](#)) that the apparent violations were egregious. In making that determination, OFAC pointed to the presence of a number of aggravating factors, including the substantial economic benefit to sanctioned parties, the scope and severity of the apparent violations, and the awareness of the conduct within the Bank. While these past actions by the Bank contributed to the imposition of a large penalty, OFAC credited the Bank with taking certain positive steps, including voluntarily disclosing the apparent violations, taking remedial actions to reduce the likelihood of further violations, and providing extensive and substantial cooperation to OFAC’s investigation, all of which are viewed as mitigating factors under OFAC’s enforcement guidelines.

The Bank also consented to the issuance of the [C&D Order](#) by the FRB. Under the C&D Order, the Bank will be required to provide the FRB and the Swiss Financial Market Supervisory Authority (“FINMA”), the Bank’s home country supervisor, with an enhanced OFAC compliance program. Among other things, the C&D Order states that this compliance program should address (1) assessment of OFAC compliance risks related to the Bank’s business outside of the United States, (2) policies and procedures to ensure compliance with U.S. laws regarding cross-border payments, (3) establishment of a compliance reporting system to capture transactions involving OFAC-sanctioned persons and jurisdictions, (4) procedures for integrating the OFAC compliance program into the Bank’s overall compliance programs, (5) adequate training of the Bank’s employees, (6) an audit program to test OFAC compliance, and (7) an annual review of the OFAC compliance

program by qualified personnel of the Bank or consultants. The Bank will be required to adopt the approved compliance program within ten days of approval by the FRB, and will need to report to the FRB and FINMA regarding its compliance with the program on a quarterly basis.

The Bank agreed to the fines as part of deferred prosecution agreements with the U.S. Department of Justice and the New York County District Attorney's Office and in settlement of civil claims by OFAC. Under the terms of the settlement, the Bank will pay \$268 million to the U.S. government and \$268 million to the New York County District Attorney's office.

OTHER ITEMS OF NOTE

SEC Adopts Amendments to Advisers Act Custody Rule

At its open meeting on December 16, 2009, the SEC adopted amendments to Rule 206(4)-2 under the Investment Advisers Act of 1940, which addresses custody of client assets by registered advisers. The SEC has not posted a formal release for the amendments. The [press release](#) describing this action focuses on three new requirements. First, an independent public accountant must conduct an annual "surprise exam" of an adviser that has custody of client assets as defined under the Rule to verify that client assets exist, and the accountant must report to the SEC if client assets are missing. In her remarks at the open meeting, SEC Chairman Mary L. Schapiro indicated that the surprise exam requirement will not apply when an adviser is deemed to have custody because an affiliate has custody of clients assets, provided the adviser is operationally independent of the affiliated custodian, *i.e.*, there is no overlap of personnel or office space, and no common supervision. Second, when an adviser or its affiliate serves as custodian of client assets, the adviser must obtain a custody controls report prepared by an accountant registered with and subject to regular inspection by the PCAOB. Finally, advisers to "hedge funds and other private funds" that comply with the custody rule by delivering audited fund financial statements to fund investors must use an auditor registered with and subject to regular inspection by the PCAOB to conduct the audit. The effective date of these amendments is 60 days after their publication in the *Federal Register*.

SEC Publishes for Comment Proposed FINRA Rule Changes Covering Marketing Materials for Variable Products

The SEC has published for public comment [FINRA's proposed rule changes](#) regarding marketing material for variable annuities and variable life insurance (collectively, "variable products"). FINRA proposes to adopt new FINRA Rule 2211 as a replacement for current NASD Interpretive Material 2210-2 (IM-2210-2). New FINRA Rule 2211 would modify some of the existing requirements of IM-2210-2 and codify some of the FINRA staff interpretations that have developed through the advertising filing program since IM-2210-2 was adopted in 1993. The [October 27, 2009 Alert](#) highlighted key provisions of the proposal. The [August 5, 2008 Alert](#) summarized FINRA's initial proposal.

The deadline for comments is December 30, 2009.

Basel Committee Proposes Strengthened Capital and Liquidity Regulations

The Basel Committee on Banking Supervision (the “Basel Committee”) issued two papers entitled: (i) *Strengthening the Resilience of the Banking Sector* and *International Framework for Liquidity Risk Measurement, Standards and Monitoring* (the “Papers”) designed to strengthen global capital and liquidity regulation. The Papers, among other things, propose the use of a global leverage ratio, a strengthened definition of core capital and new standards for monitoring liquidity risks. The Basel Committee requested that comments on the Papers be submitted by April 16, 2010, and the FRB, FDIC, OCC and OTS, which are members of the Basel Committee, issued releases encouraging financial institutions to submit comments on the Papers. The Basel Committee stated that it did not expect that the requirements suggested in the Papers would be implemented for a number of years, and only after the banking industry has recovered from the current global economic crisis.

PARTNERS AND COUNSEL

[Marco E. Adelfio](#)
[Lynne B. Barr](#)
[Gary A. Beller](#)
[Raymond P. Boulanger](#)
[John J. Cleary](#)
[Daniel T. Condon](#)
[Margaret B. Crockett](#)
[James S. Dittmar](#)
[Anna E. Dodson](#)
[Eric R. Fischer](#)
[James O. Fleckner](#)
[Elizabeth Shea Fries](#)
[Lynda T. Galligan](#)
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[John Hunt](#)
[James J. Kelly](#)
[Robert G. Kester](#)
[Robert M. Kurucz](#)
[Thomas J. LaFond](#)
[Paul W. Lee](#)
[William P. Mayer](#)
[Philip H. Newman](#)
[Sean P. O'Malley](#)
[Christopher E. Palmer](#)
[Byron C. Pavano](#)
[Regina M. Pisa](#)
[Mark S. Raffman](#)
[Robert S. Seigal](#)
[Brenda R. Sharton](#)
[Kevin L. Sheridan, Jr.](#)
[Derek N. Steingarten](#)
[William E. Stern](#)
[Marian A. Tse](#)
[Kimberly K. Vargo](#)
[Scott A. Webster](#)
[Michael P. Whalen](#)

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