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# FINANCIAL SERVICES ALERT

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***Developments of Note***



## DEVELOPMENTS OF NOTE

### SEC's Division of Investment Management Provides Guidance on the Timing of Compliance by Registered Funds with New Corporate Governance Disclosure Requirements

The staff of the SEC's Division of Investment Management has posted guidance on how registered funds comply with the new corporate governance disclosure requirements described in the December 22, 2009 *Alert*. The SEC's adopting release indicated an effective date of February 28, 2010 but did not explain how this applied to the different types of filings subject to the new requirements. Under the guidance, an important factor in determining how soon a fund must comply with the new requirements is whether the fund's fiscal year ends on or after December 20, 2009.

**Fiscal year ending on or after December 20, 2009**

*Registration Statement/Post-Effective Amendment.* A registration statement or post-effective amendment filed on or after February 28, 2010 must comply with the new disclosure requirements.

*Proxy Statement.* A proxy statement filed on or after February 28, 2010 must comply with the new requirements. A fund that is filing a preliminary proxy statement and expects to file its definitive proxy statement on or after February 28, 2010, must comply with the new requirements in the preliminary proxy statement, even if it is filed before February 28, 2010.

**Fiscal year ending before December 20, 2009**

A registration statement, post-effective amendment or proxy statement is not required to comply with the new disclosure requirements unless filed after the end of the fund's 2010 fiscal year (even if filed on or after February 28, 2010).

**New Fund**

A filing on or after December 20, 2009 for a new fund, whether in a new registration statement or a post-effective amendment, must comply with the new disclosure requirements to be declared effective or become effective automatically on or after February 28, 2010.

**Fund Whose Series have Different Fiscal Year Ends**

A post-effective amendment filed on or after February 28, 2010 to make changes that affect a series with a fiscal year that ends on or after December 20, 2009 must comply with the new requirements.

**Voluntary Compliance**

Early voluntary compliance with some or all of the new requirements is permitted.

## Federal Banking Agencies Issue Guidance for Cross-Border Funds Transfers

The federal banking agencies (the "Agencies"), in consultation with the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") and Financial Crimes Enforcement Network, published guidance (the "Guidance") for U.S. banks that are involved in so-called "cover payment" arrangements. The Guidance is titled *Transparency and Compliance for U.S. Banking Organizations Conducting Cross Border Funds Transfers*. The Guidance addresses issues that were discussed in a May 2009 paper by the Basel Committee on Banking Supervision on cover payment arrangements (the "BIS Paper"), and specifies the Agencies' expectations for U.S. banks that participate in cover payment arrangements.

"Cover payment" arrangements may be used by banks to facilitate the transfer of funds when (1) the transfer involves a transaction in currency other than that of the country in which the originator's bank or beneficiary's bank is domiciled and (2) the originator's bank and beneficiary's bank do not have a relationship that allows them to settle directly with each other. Under these arrangements, the originator's bank directly instructs the beneficiary's bank to effect the payment, but the transmission of funds to "cover" the obligation is arranged through a separate channel of intermediary banks. The Guidance notes that if the originator's bank does not send full transaction information to its "cover" intermediary, the lack of transparency can impair the cover intermediary's risk management and compliance efforts, particularly for cross-border transactions.

In the BIS Paper, which was published in response to an April 2007 statement of the Wolfsburg Group and The Clearing House Association, the Basel Committee, the Basel Committee addressed supervisory expectations regarding information in cover payment messages and the roles of each bank involved in a cover payment arrangement. The Basel Committee explained that the originator's bank is responsible for making sure that complete information about the originator and beneficiary is included in each wire transfer instruction. A cover intermediary bank must provide that information to each bank in the payment chain, and is also responsible for screening originator and beneficiary names against sanctions lists. Finally, the beneficiary's bank is responsible for verifying the identity of and conducting due diligence and monitoring on the beneficiary.

As explained in the BIS Paper, cover payments effected through SWIFT became more transparent beginning on November 21, 2009, when the new MT 202 COV payment format took effect. The MT 202 COV includes mandatory fields for information about originators and beneficiaries that was not previously completed by banks using the MT 202.

The Guidance explains the Agencies' expectations for banks involved in cover payment arrangements. First, the Guidance states that U.S. originators' banks must use the MT 202 COV for all cover payment transactions, regardless of whether there is a cross-border transfer. By using the MT 202 COV, the originator's bank also may comply with other applicable messaging regulations, such as the so-called "Travel Rule" by completing the MT 202 COV. For bank-to-bank transactions that are not cover payments, such as bank-to-bank transfers for correspondent accounts, originators' banks are not required to use the MT 202 COV.

The Guidance also sets forth the Agencies' expectations for U.S. banks that are cover intermediaries. First, U.S. cover intermediaries should conduct OFAC screening on all originators and beneficiaries named in the MT 202 COV. While such screening requirements are not new, the Guidance notes that the MT 202 COV provides more information for screening than the MT 202 format. Second, the Guidance notes that SWIFT will reject any MT 202 COV containing a blank field for the originator or beneficiary. Third, U.S. cover intermediary banks should use the additional information provided by the MT 202 COV when monitoring funds transfers that are processed through their automated systems for potentially suspicious activity. Banks are not expected to gather information relating to incomplete fields or to verify the accuracy of information in the MT 202 COV, but should apply a risk-based approach that enables them to identify fields that are "manifestly meaningless or incomplete." Fourth, although requirements for intermediaries using the MT 202 have not changed, a cover intermediary should factor into its risk assessment any correspondent bank's policy of sending messages without using the MT 202 COV where available, and should have appropriate controls in place for such circumstances.

Moreover, the Guidance provides instructions to examiners with respect to cross-border cover payments. Specifically, examiners will review a bank's anti-money laundering and OFAC risk assessments, determine whether the bank has implemented transparency standards for international funds transfers, confirm that originators' banks include complete information in cross-border funds transfer instructions, and evaluate whether the institution has processes for conducting adequate due diligence on foreign correspondent banks, as required under Section 312 of the Patriot Act.

## IRS Extends Deadline for Addition of Liquidity Facility to Support Auction Rate Preferred Stock

In July 2008, the Internal Revenue Service (the "IRS") issued Notice 2008-55, which addressed issues raised by measures proposed to resolve problems created by significant auction failures in the market for auction rate preferred stock ("ARPS"). More specifically, Notice 2008-55 announced that the IRS would not challenge the equity characterization of certain ARPS as a result of adding liquidity facilities if specified conditions are met. Among other requirements under Notice 2008-55, the ARPS must have been outstanding on February 12, 2008, or issued after that date to refinance, directly or indirectly, ARPS that was outstanding on that date. In addition, the liquidity facility must be an initial liquidity facility with respect to the ARPS that is entered into on or before December 31, 2009, or a liquidity facility that renews, replaces, or extends such an initial liquidity facility, either directly or in a series of liquidity facilities. Notice 2010-3 extends the time period during which an initial liquidity facility can be entered into under Notice 2008-55 from December 31, 2009 until December 31, 2010. For a detailed discussion of Notice 2008-55, please see the July 1, 2008 *Alert*.

## SEC Adopts Final Rule on Certain Principal Transactions for Advisers with December 31, 2010 Sunset Provision

The SEC issued a release adopting as final Rule 206(3)-3T under the Investment Advisers Act of 1940. Rule 206(3)-3T was adopted as a temporary rule in 2007 following a decision by the Court of Appeals for the District of Columbia Circuit that struck down an SEC rule addressing the application of the Advisers Act to certain activities of broker-dealers (see the April 10, 2007 *Alert* for a discussion of this decision). The Rule is designed to enable a dually registered broker-dealer's nondiscretionary customers that have converted their current fee-based brokerage accounts to fee-based advisory accounts to have continued access to securities available on a principal basis from the firm without requiring the firm to comply with the strict terms of Section 206(3)'s disclosure and consent requirements. The only change the SEC has made in making the Rule final is to extend its expiration date from December 31, 2009 to December 31, 2010. The SEC staff has posted a Small Entity Compliance Guide that summarizes and explains the Rule.

## FRB Maintains Depository Institution Exemption Threshold for Collecting HMDA Data at $39 Million

The FRB issued a release stating that depository institutions ("DIs") with total assets of $39 million or less as of December 31, 2009 would be exempt in 2010 from collecting, reporting and disclosing data about applications for, and originations and purchases of, home purchase loans, home improvement loans and refinancings under the Home Mortgage Disclosure Act ("HMDA") and the FRB's Regulation C. Under HMDA, non-exempt DIs collect and report data concerning the types, purposes and amounts of loans, the race, ethnicity, sex and income of the loan applicants, the locations of the property and, for some loans, loan price information. The FRB stated that the HMDA exemption will stay at $39 million for 2010, as it was in 2009, because the Consumer Price Index decreased by only .98%, an amount that the FRB said is too small to warrant a reduction in the asset threshold amount. The FRB noted that a DI's exemption from collecting data in 2010 does not relieve it from reporting in 2010 any data that it was required to collect in 2009.

## Federal Banking Agencies Slightly Decrease Asset-Size Thresholds for 2010 under CRA for Small and Intermediate Small Depository Institutions

The FRB, FDIC, OCC and OTS (the "Agencies") issued releases concerning small decreases for 2010 in the asset-size thresholds under the Community Reinvestment Act ("CRA") for small depository institutions ("DIs") and for small intermediate DIs. Annual

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adjustments to these CRA thresholds are made based upon changes in the Consumer Price Index (the "CPI"). The CPI decreased .98% during the measurement period and, as a result for 2010:

(1) a small DI is deemed to be a DI that had, as of either December 31, 2009 or December 31, 2008, total assets of less than $1.098 billion; and

(2) a small intermediate DI is deemed to be a small DI that had, as of both December 31, 2008 and December 31, 2009, assets of at least $274 million, and that had, as of either December 31, 2008 or December 31, 2009, total assets of less than $1.098 billion.

The foregoing asset-size threshold adjustments are effective January 1, 2010.

Happy New Year!