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DEVELOPMENTS OF NOTE

FinCEN Adopts Rule to Expand Section 314(a) Information Sharing Procedure

The U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") adopted a [rule](#) (the "Final Rule") to expand the range of law enforcement agencies eligible to make requests for information under the information sharing procedures adopted by FinCEN pursuant to Section 314(a) of the USA Patriot Act. The Final Rule was adopted without modification to FinCEN's proposed rule, which was described in the [November 24, 2009 Alert](#).

Under the Final Rule, which was effective on February 10, 2010, state, local, and certain foreign law enforcement agencies will now be able to request that FinCEN require U.S. financial institutions to search their records to determine whether they have maintained an account or conducted a transaction with specified individuals, entities, or organizations suspected of engaging in terrorist activity or money laundering (such requests are referred to below as "Section 314(a) Requests"). The Final Rule also allows FinCEN to initiate Section 314(a) Requests on its own behalf on or on behalf of other divisions of the U.S. Treasury Department. Prior to adoption of the Final Rule, only federal law enforcement agencies were eligible to make Section 314(a) Requests.

In the preamble to the Final Rule, FinCEN responded to various issues raised by commenters regarding the proposed rule. For example, some commenters requested clarification of the requirements for foreign, state, and local law enforcement agencies that submit Section 314(a) Requests. Like federal law enforcement agencies, a foreign, state, or local law enforcement agency making a Section 314(a) Request must certify that each individual, entity or organization about which is seeking information is engaged in, or is reasonably suspected of engaging in, terrorist financing or money laundering, and, in the case of a money laundering investigation, the matter is significant and the law enforcement agency has not been able to locate the requested information through traditional methods of investigation. FinCEN explained that such certifications from foreign, state, and local law

enforcement agencies must include a citation of the relevant statutory provisions; a description of the suspected criminal conduct; for money laundering cases, a description of why the case is significant; and a list of the traditional methods of investigation and analysis which have been conducted prior to making the request.

In response to comments asking for clarification of the steps foreign, state, and local law enforcement agencies will need to take in the event a financial institution reports a match, FinCEN noted that such steps are not addressed by the Final Rule. Foreign, state, and local law enforcement agencies will instead need to continue to follow the standard procedures that they currently follow in order to obtain financial information from financial institutions, such as through issuance of a subpoena, a letter rogatory, or a national security letter. FinCEN also dismissed comments raising concerns about the confidentiality of information that would be shared by FinCEN with foreign, state, and local law enforcement agencies, explaining that the information in a Section 314(a) Request response, which consists of only a confirmation that a matching account or transaction exists, is extremely limited.

FRB Chairman Bernanke Announces Exit Strategy for Crisis Response Programs, Including by Raising Interest Rates on Reserve Balances

In [written testimony](#) to the House Financial Services Committee, FRB Chairman Ben Bernanke outlined the FRB's exit strategy from the extraordinary lending and monetary policies it established in response to the financial crisis and recession which have caused the FRB's balance sheet to grow to more than \$2.2 trillion. "As a result of the very large volume of reserves in the banking system, the level of activity and liquidity in the federal funds market has declined considerably, raising the possibility that the federal funds rate could for a time become a less reliable indicator than usual of conditions in short-term money markets," Chairman Bernanke stated. Instead, Chairman Bernanke indicated that the FRB is turning to the interest rate paid on reserves – currently at 0.25% - as an alternative short term interest rate. The FRB was granted the authority to pay interest on reserves in October 2008. As of February 3, 2010, U.S. banks had more than \$1.1 trillion on deposit with the Federal Reserve Banks. An increase in the interest rate paid on reserves would encourage banks to increase their reserve deposits, which would result in less money in the banking system.

Chairman Bernanke also highlighted two other tools the FRB is developing to remove liquidity from the financial system: reverse repurchase agreements and term deposits. Under the reverse repurchase agreements, the FRB sells a security to a counterparty with an agreement to repurchase the security at some date in the future. Chairman Bernanke stated that "the counterparty's payments to the FRB has the effect of draining an equal quantity from the banking system." He further stated that the FRB has enhanced its ability to use reverse repurchase agreements to absorb very large quantities of reserves. Chairman Bernanke indicated that the FRB's capability to carry out these transactions with primary dealers, using the its holdings of Treasury and agency debt securities, has already been tested and is currently available. To further increase its capacity to drain reserves through reverse repurchase agreements, Chairman Bernanke stated that the FRB is in the process of expanding the set of counterparties with which it can transact and developing the infrastructure necessary to use its mortgage-backed securities holdings as collateral in these transactions.

The FRB has also been developing term deposits for depository institutions, which are roughly analogous to certificates of deposit. Under the term deposit facility, depositor

banks would receive a separate account that would earn interest and mature within a year. Such term deposits could not be used by banks to meet their short-term liquidity needs and would not be counted as reserves. Chairman Bernanke stated that the FRB would likely auction large blocks of such deposits. He expects the FRB “to conduct test transactions this spring and to have the facility available if necessary shortly thereafter.” Chairman Bernanke stated that reverse repurchase agreements and term deposits would “together allow the [FRB] to drain hundreds of billions of dollars of reserves from the banking system quite quickly, should it choose to do so.”

Chairman Bernanke gave no indication of when the FRB will tighten its monetary policy, but stated that the “sequencing of steps and the combination of tools that the [FRB] uses as it exits from its currently very accommodative policy stance will depend on economic and financial developments.” “As the time for the removal of policy accommodation draws near, those operations could be scaled up to drain more significant volumes of reserve balances to provide tighter control over short-term interest rates,” he said. “The actual firming of policy would then be implemented through an increase in the interest rate paid on reserves.”

Chairman Bernanke said that he has no plans to sell the \$175 billion in debt and \$1.25 trillion in mortgage-backed securities of Fannie Mae and Freddie Mac that the FRB expects to have purchased by the end of March 2010. He noted that the debt and mortgage-backed securities are being allowed to mature and run off the FRB’s balance sheet, but stated that the FRB could begin selling such securities “when the economic recovery is sufficiently advanced.” He further stated that any such sales “would be at a gradual pace, would be clearly communicated to market participants and would entail appropriate consideration of economic conditions.”

Chairman Bernanke noted that the terms of discount window lending are returning to normal after an extended period of longer maturities and lower interest rates than is typical. He also stated that the use of the FRB’s liquidity programs, such as the Term Auction Facility, the Primary Dealer Credit Facility and the Term Asset-Backed Securities Lending Facility, has fallen sharply and such programs have either closed or are scheduled to be phased out in the coming months.

Senate Regulatory Reform Efforts Move Forward as Senator Dodd Reaches an Impasse with Senator Shelby, Moves Forward with Senator Corker

Senate Banking Committee Chairman Christopher Dodd and Ranking Member Richard Shelby announced that they have reached an impasse in their bipartisan efforts to craft a comprehensive financial markets regulatory reform bill. It is believed that their talks fell apart over whether an independent consumer protection division within a regulatory agency could have rule-making authority. Senator Dodd had previously agreed to scrap a proposal for a new independent agency the Consumer Financial Protection Agency, in favor of an independent consumer protection division within a financial regulatory agency. In December 2009, the House of Representatives passed the Wall Street Reform and Consumer Protection Act of 2009, which would establish an independent Consumer Financial Protection Agency. No Republican members of the House voted for the bill.

The Senate Banking Committee had formed four bipartisan working groups to address specific regulatory reform subjects. Senators Dodd and Shelby worked on consumer protection and prudential banking regulation; Senators Jack Reed and Judd Gregg worked

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on derivatives and credit-rating agencies; Senators Mark Warner and Bob Corker worked on the resolution of major financial institutions; and Senators Charles Schumer and Michael Crapo worked on executive compensation and corporate governance. Senators Dodd and Corker have announced they will continue to work on the bipartisan legislation, setting aside for the moment consumer protection issues. Senator Corker stated that he was willing to be the lone Republican vote for financial markets regulatory reform, but that he believes the Senate Banking Committee will draft a bill that other Republicans would be comfortable supporting.

OFAC Issues Proposed Belarus Sanctions Regulations

The U.S. Treasury Department's Office of Foreign Assets Control ("OFAC") published [proposed regulations](#) (the "Belarus Regulations") that would codify in the Code of Federal Regulations the Belarus sanctions put in place by Executive Order 13405 in June 2006.

The Belarus Regulations, which generally track the prohibitions set forth in Executive Order 13405, block the property of any person determined by the Secretary of Treasury, in consultation with the Secretary of State, (i) to be responsible for, or to have participated in, actions or policies that undermine democratic processes or institutions in Belarus; (ii) to be responsible for, or have participated in, human rights abuses related to political repression in Belarus; (iii) to be a senior-level official (or family member or other closely linked person of a senior level official) who has engaged in public corruption related to Belarus; (iv) to have provided material assistance or support to such an individual or entity, or (v) to be owned, controlled by, or acts on behalf of such an individual or entity. Any property or interest of such blocked persons may not be transferred, paid, exported, withdrawn, or dealt in by any U.S. individual or entity. Like the Weapons of Mass Destruction Proliferators sanctions regulations adopted in 2009, the Belarus Regulations specify that the property and interests of any entity in which a blocked person owns, directly or indirectly, a 50 percent or greater interest, are also blocked, regardless of whether such a subsidiary of the blocked person has been specifically designated by OFAC under the Belarus Regulations.

The Belarus Regulations, which are primarily a property blocking regime, do not impose the broader types of prohibitions established by OFAC's more comprehensive sanctions programs, such as Cuba, Iran, and Sudan. The Belarus Regulations' prohibitions also do not apply to personal communications not involving the transfer of anything of value; subject to certain limited exceptions, to imports or exports of information or information materials; and to transactions ordinarily incident to travel to or from Belarus.