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DEVELOPMENTS OF NOTE

Lynne Barr Receives Lifetime Achievement Award from American College of Consumer Financial Services Lawyers

The American College of Consumer Financial Services Lawyers recently honored our Financial Services Group partner, Lynne Barr with its Senator William Proxmire Lifetime Achievement Award at the College's annual dinner. The College is an invitation-only group of prominent consumer financial services lawyers, of which Lynne is a fellow and past president.

The Proxmire Award is granted periodically by the College to a person who has made significant contributions in the field of consumer financial services over that person's career. William Proxmire was a U.S. Senator who served as Chairman of the Committee on Banking, Housing and Urban Affairs. Among his many accomplishments, he was the chief sponsor and was largely responsible for the Consumer Credit Protection Act, major legislation that created a national framework for bringing fairness to consumers entering into credit transactions.

FFIEC Releases Updated Bank Secrecy Act/Anti-Money Laundering Manual

The Federal Financial Institutions Council (“FFIEC”) released the 2010 version of its [Bank Secrecy Act/Anti-Money Laundering \(BSA/AML\) Examination Manual](#) (the “Revised Manual”). The Revised Manual is the result of a joint effort by the Federal Reserve Board, the FDIC, the NCUA, the OCC, the OTS, the State Liaison Committee, and FinCEN, with input from OFAC on appropriate sections. The updates to the Revised Manual, which the FFIEC explained has been revised to further clarify supervisory expectations since the last update in August 2007, are based on feedback provided by the banking industry and examination staff.

In releasing the Revised Manual, the FFIEC stated that the most significant updates include: (1) addition of a new section on bulk currency shipments; (2) substantial revisions to the section on Enterprise-Wide BSA/AML Compliance programs, which has been retitled “BSA/AML Compliance Program Structures,” including an enhanced discussion of consolidated compliance programs; (3) streamlining and reorganization of core examination procedures for evaluating BSA/AML compliance; (4) further guidance to examiners for determining when a violation is systemic or recurring; (5) updates to address new regulations and guidance in the Revised Manual’s sections regarding currency transaction reporting (“CTR”) exemptions, reporting of foreign bank and financial accounts (“FBARs”), electronic banking, and third party payment processors; (6) revisions to reflect industry practices and developments in the Revised Manual’s sections regarding funds transfers, ACH transactions, and trade finance activities; (7) an enhanced and reorganized section regarding suspicious activity reporting (“SARs”), including the addition of a new Appendix S regarding the key components of a SAR monitoring program; and (8) updates to the Revised Manual’s section on electronic cash to include a more detailed discussion of prepaid cards. The sections of the Revised Manual with the most significant updates have been identified by noting them with the year (2010) in the table of contents.

FDIC Releases Additional FAQs Regarding Private Equity Investments

The FDIC released [additional FAQs](#) on April 23, 2010 regarding its Statement of Policy on Qualifications for Failed Bank Acquisitions (“Statement of Policy”). The additional FAQs were released to address questions received by the FDIC since its previous FAQ release on January 7, 2010. The additional FAQs provide additional guidance regarding the scope of the Statement of Policy.

By its terms, the Statement of Policy does not apply with respect to investors in partnerships or similar ventures with bank or thrift holding companies or in such holding companies where the holding company has a “strong majority interest in the resulting bank or thrift and an established record for successful operation of insured banks or thrifts.” The FAQs clarify that, in determining whether investors in an institution who made their investments prior to a failed bank acquisition are subject to the Statement of Policy, the FDIC will take into consideration whether a “significant portion” (a term the FDIC does not define) of the total equity or voting equity in the institution was “recently acquired” (a term the FDIC does not define) or was part of a “recapitalization” (a term the FDIC does not define) of the existing institution. If the FDIC determines that a pre-existing investment was part of a recapitalization, the FAQs state that the Statement of Policy will apply if one or more failed bank acquisitions occur that in combination exceed 100% of the recapitalized institution’s total assets within an eighteen-month period following the recapitalization.

In the January 7, 2010 FAQs, the FDIC stated that the Statement of Policy would not apply where private investors have one-third or less of the total equity shares and voting equity shares of the institution making the failed bank acquisition. The new FAQs clarify that if the Statement of Policy applies because the one-third ownership threshold has been crossed, investors holding a minimum of either (1) one-third of the total voting equity shares or (2) one-third of a combination of total voting equity shares and total equity shares as a proportion of total equity shares, must be bound by the terms of the Statement of Policy. This “anchor group” would consist of all holders of more than 5% of the voting equity shares and any holders of 5% or less of the voting equity shares that elect to be subject to the Statement of Policy.

The FAQs clarify that if an investor has a right to designate a board member, then the investor will be subject to the Statement of Policy, even if the investor owns 5% or less of the voting equity shares of the institution. Senior management is not automatically subject to the Statement of Policy, absent voting equity share ownership, a right to designate a board member, or evidence of concerted action.

The FAQs also clarify that holders of 5% or less of the voting equity shares are subject to being included on the “List of Investors” provided to the FDIC and are required to provide limited information to the FDIC, including the investor’s name; type of vehicle through which it is investing; domicile; and ownership of equity and equity equivalents by the investor and its affiliates or immediate family members both before and after the equity raise.

Finally, the FAQs provide detail regarding compliance by a non-U.S. investor domiciled in a “bank secrecy jurisdiction” with the Statement of Policy, including the requirement that the non-U.S. investor make its investment through a U.S. subsidiary, maintain books and records in the United States, and make such books and records available to the FDIC upon request.

Federal Banking Agencies Issue Final Guidance on Correspondent Concentration Risks

The FDIC, FRB, OCC and OTS (the “Agencies”) jointly issued [final guidance](#) (the “Guidance”) concerning correspondent concentration risks. A proposed version of the Guidance (the “Proposed Guidance”) was discussed in the [September 29, 2009 Alert](#). The Agencies state that concentration risks can occur in correspondent relationships when a financial institution (“FI”) engages in a significant volume of activities with another FI. The Guidance focuses on the need for FIs to identify, monitor and manage correspondent concentration risk on a stand-alone and enterprise-wide basis. Appropriate due diligence should be performed, say the Agencies, “on all credit exposures to, and funding transactions with, other [FIs] as part of their risk management policies and procedures.” Correspondent relationships can result in credit (asset) concentration risks and funding (liability) concentration risks. The Agencies note that correspondent risks represent a lack of risk diversification, and the Guidance states that the Agencies generally consider credit exposures equal to or more than 25% of total capital as concentrations and funding exposures as low as 5% of an FI’s liabilities as concentrations. In the Proposed Guidance, 25% or more of Tier 1 capital (rather than total capital) was regarded as a concentration. The Guidance provides that management of FIs should (1) identify an FI’s aggregate credit and funding exposures to other FIs and their respective affiliates; (2) specify what information, ratios or trends will be monitored for each correspondent; (3) set prudent

correspondent concentration limits and tolerances for factors being monitored and plan for managing concentrations in excess of those limits; and (4) conduct an independent analysis before entering into any credit or funding transactions with another FI. FIs should be in a position to react quickly to changing circumstances in the level of risk posed by a correspondent relationship. The Guidance supplements rather than supersedes prior regulatory guidance. The Guidance is effective May 4, 2010.

OCC Issues Interpretive Letter Confirming Authority of National Bank to Hold Auction Rate Preferred Securities for its Own Account

The OCC issued an [interpretive letter](#) (“Letter #1126”) in which it concluded that a national bank (the “Bank”) had the authority to purchase and hold auction rate preferred securities (“ARPS”) for its own account subject to certain representations and conditions. In the proposed transaction, a subsidiary of the Bank proposed buying ARPS as Type III investment securities from two other affiliates of the Bank at fair value for the purposes of fully realizing the tax-exempt benefits of the ARPS. The Bank affiliate represented that the ARPS carried many of the same debt-like characteristics that had been previously approved by the OCC under Interpretive Letter # 1115 and that the ARPS met the quality and marketability requirements of Type III investment securities under 12 C.F.R. Part 1.

The OCC found that it would permit the purchase by the Bank affiliate with the following conditions:

- The Bank could only exercise its voting rights under the ARPS instruments where the rights and seniority of the ARPS holders could be adversely affected. The OCC wants to ensure that banks limit their voting rights to those commonly associated with the holder of debt instruments.
- The Bank is required to enter into an operating agreement with the OCC which requires the Bank to enter into an indemnification and repurchase agreement (the “Agreement”), satisfactory to the OCC, with the Bank’s holding company, pursuant to which the holding company represents that it will cover certain losses and expenses that the Bank and any of its subsidiaries will incur as a result of the ARPS purchase. The agreement must be entered into within 30 days of the Bank subsidiary’s ARPS acquisitions.
- The Agreement shall provide that the Bank’s holding company shall repurchase the ARPS no later than two years after purchase.
- The Bank’s Board of Directors shall assure that the operating agreement is fully adopted, timely implemented and adhered to thereafter.

FRB Issues Final Rule Amending Regulation D to Authorize Reserve Banks to Offer Term Deposits

The FRB issued a [final rule](#) (the “Final Rule”) amending the FRB’s Regulation D to authorize the Federal Reserve Banks to offer terms deposits. A Notice of Proposed Rulemaking (the “NPR”) regarding these amendments was discussed in the [January 5, 2010 Alert](#). The Final rule makes a few changes from the NPR to reflect public comment. Specifically, the FRB in the Final Rule: (1) determines not to adopt a sunset provision for amendments to Regulation D and allows term deposits to be used “as needed

based on monetary policy objectives;" (2) changes the definition of "short term interest rates" to make it more consistent with market practices; (3) clarifies that the FRB may set conditions regarding the early withdrawal of term deposits and pledging term deposits as collateral; and (4) clarifies that term deposits may not be used for general payments or settlement activities. The Final Rule will take effect 30 days after publication in the *Federal Register*.

FinCEN Issues Advisory on Reverse Mortgages

The Financial Crimes Enforcement Network ("FinCEN") released an [advisory](#) (the "Advisory") to assist financial institutions in detecting reverse mortgage fraud schemes targeted at participants in the Federal Housing Administration's Home Equity Conversion Mortgage ("HECM") program, the only reverse mortgage program insured by the U.S. government. As the HECM program, which accounted for nearly 100 percent of the reverse mortgage market in 2009, has grown in popularity, public reports of crimes against participants in the HECM program have increased. The HECM program is available only to people who are at least 62 years of age ("Seniors").

The Advisory reminds financial institutions that they have an obligation to file a suspicious activity report if they suspect that a transaction involves funds derived from illegal activities. It highlights six types of fraudulent reverse mortgage schemes and provides red flags that could be signs of fraudulent activity:

1. **Cross Selling.** Loan officers or other individuals may convince a Senior who receives proceeds from a HECM loan to invest the proceeds in expensive and unnecessary financial products in violation of HUD rules. **Red Flags:** If a Senior deposits little or no funds in his or her bank account after receiving HECM loan proceeds or mentions that he or she has invested his or her HECM loan proceeds in a financial product, these could be red flags.
2. **Cash-out Theft.** A third party who the Senior entrusts with the proceeds check from his or her HECM loan may steal the funds by depositing it into an account that the Senior does not control. **Red Flags:** A Senior's election to receive his or her HECM loan proceeds in a lump sum or a loan officer's out-of-the ordinary deposit or withdrawal of large amounts of cash could be red flags.
3. **Property Flipping.** A fraudster may convey a low-value property to a Senior, then instruct the Senior (or assume the Senior's identity) to obtain a reverse mortgage on the property based on an inflated estimate of the property's value. **Red Flags:** A Senior's claim that he or she received the house at no cost as part of a government program, an appraisal that takes into account irrelevant comparable sales (such as outdated sales or those from beyond the property's neighborhood), or inconsistencies between the Senior's credit report and his or her HECM loan application could be red flags.
4. **Fake Down Payments.** A variation on item 3, this fraud similarly involves the conveyance of a low-value property to a Senior. Here, the fraudster falsifies paperwork to create the appearance that the Senior put down a large down payment on the property. **Red Flags:** The red flags here are the same as those for item 3.
5. **Distressed Non-Senior Mortgagors.** Fraudsters who have distressed mortgages but are too young to qualify for a HECM loan may deed their property to Seniors who are family members or acquaintances so that the Senior may take out a reverse mortgage on their behalf. The fraudster will then keep the proceeds of the reverse mortgage. **Red Flags:**

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If a distressed mortgagor deeds his property to the Senior who then takes out a HECM loan to repay the mortgage or if there are other indicators that the proceeds are going to someone other than the Senior (for example, if the proceeds are deposited in someone else's account or paperwork associated with the HECM loan is sent to someone other than the Senior), these could be red flags.

6. ***Power of Attorney.*** Often when employing the schemes listed above, fraudsters will obtain a power of attorney, which enables them to apply for HECM loans without the full knowledge of the Senior.

OTHER ITEM OF NOTE

Independent Directors Council Issues Paper on Board Oversight of Target Date Funds

The Independent Directors Council (IDC) issued a [paper](#) designed to assist the directors of target date and lifecycle funds with their oversight responsibilities. The paper focuses primarily on potential areas of inquiry for target date fund boards, including (i) portfolio performance, (ii) advisory fees and their approval and (iii) disclosure and distribution. The IDC paper is available along with other materials on target date/lifecycle funds at the [Target Retirement Date Funds Resource Center](#) maintained by the Investment Company Institute.