GOODWIN | PROCTER

July 20, 2010
Vol. 13 No. 49

FINANCIAL SERVICES ALERT

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EDITORS

Eric R. Fischer
Jackson B.R. Galloway
Elizabeth Shea Fries

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DEVELOPMENTS OF NOTE

President Obama Expected to Sign Dodd-Frank Act Tomorrow

President Obama is expected to sign the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") tomorrow. The *Alert* expects to publish a summary of the Act shortly and to provide in-depth coverage throughout the coming months of issues raised by, and subsequent regulations adopted under, the Dodd-Frank Act.

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Dodd-Frank Act to Change Accredited Investor Definition for Individuals to Exclude Primary Residence from Net Worth Calculation

The Dodd-Frank Act, includes a change to the definition of an individual "accredited investor" in Regulation D under the Securities Act of 1933. This provision would have an apparently immediate effect on companies of all types, including those outside the financial services industry, and on private funds. Specifically, Section 413 of the Dodd-Frank Act provides that the SEC must adjust the definition of "accredited investor" under Regulation D to exclude the value of a natural person's primary residence when calculating that person's net worth. However, because Section 413 contemplates both that the SEC must act to give it effect and that the new standard takes effect on the date of enactment of the law (as show below, with emphasis added), there may be some ambiguity as to when this change actually takes effect.

> "**The Commission shall adjust** any net worth standard for an accredited investor, as set forth in the rules of the Commission under the Securities Act of 1933, so that the individual net worth of any natural person, or joint net worth with the spouse of that person, at the time of purchase, is more than $1,000,000 (as such amount is adjusted periodically by rule of the Commission), excluding the value of the primary residence of such natural person, except that during the 4-year period **that begins on the date of enactment of this Act**, any net worth standard shall be $1,000,000, excluding the value of the primary residence of such natural person."

Also, it is not clear when or how the SEC will act on this provision (and whether it might address the potential problem resulting from this uncertainty regarding timing). Issuers in the process of preparing, distributing and accepting subscriptions in connection with a pending private placement relying on Regulation D may wish to consider obtaining appropriate representations from individual investors addressing the Dodd-Frank Act's accredited investor standard even before the legislation is formally enacted.

Judge Finds Breach of ERISA Fiduciary Duty Where Plan Fiduciary Failed to Consider Institutional Share Class Mutual Funds for Large 401(k) Plan

In an 82 page order dated July 8, 2010, released on July 12, 2010, Judge Wilson of the United States District Court for the Central District of California held that fiduciaries of a 401(k) plan holding between $2 and $3 billion in assets breached ERISA's duty of prudence as to three of nearly fifty investments made available to plan participants where the fiduciaries utilized retail mutual funds as opposed to available institutional class shares for those three funds. The amount of damages is to be decided by the court at a later date. *Tibble v. Edison International*, No. CV 07-5359 SVW (AGRx), 2010 WL 2757153 (C.D. Cal. Jul. 8, 2010).

Edison is one of sixteen nearly identical class action suits brought by a St. Louis plaintiff's firm challenging under ERISA fees paid by large 401(k) plans. Plaintiffs are 401(k) plan

participants. Defendants include the plan sponsor and those corporate committees and individuals employed by the sponsor with authority over the 401(k) plan. Judge Wilson conducted a three day trial from October 20-22, 2009 on two limited issues that remained in the case after he had granted Defendants' motion for summary judgment in large part in orders dated July 16, 2009 and July 31, 2009.

As to the first trial issue, the court held that Defendants acted imprudently by selecting retail as opposed to institutional shares for three of the mutual funds challenged by Plaintiffs. The court found that the Defendants had not evaluated or considered the existence of alternative share classes for these funds and that the selection of retail share classes under the facts adduced at trial was objectively imprudent where "the institutional share classes offered the exact same investment at a lower cost to the Plan participants." The court further ruled that defendants' reliance on their investment consultant was not a defense to the charge that they acted imprudently. Had the plan been designed to provide that all such plan expenses were to be paid by the plan, rather than the plan sponsor, the fiduciaries might have been able to justify the prudence of selecting the retail share classes based upon an additional argument that was not addressed in the court's ruling: that the benefit that the plan (not the plan sponsor) derived from the revenue sharing justified payment of the higher fees with respect to the retail classes. As such, this decision underscores the importance of designing such a plan so as to impose the cost of plan administration on the plan, not the plan sponsor.

The plaintiffs also claimed that the selection of these three share classes was a violation of ERISA's duty of loyalty, because these classes generated payments of revenue sharing that were applied to reduce plan expenses that would otherwise have been borne by the plan sponsor. The court concluded that defendants did not act disloyally by allowing the challenged mutual funds to be offered as plan investment options, where the proof at trial showed that defendants' actions were not motivated to any extent by the existence of such revenue sharing payments.

As to the other issue at trial, the Court held that it was not imprudent to allow investment in a money market fund that charged a management fee between 8 and 18 basis points. The court held that the fund charged fees in a reasonable range, and, in reliance on *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009), stated that: "The fact that it is possible that some other funds might have had even lower [expense] ratios is beside the point; nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)."

Basel Committee Issues Countercyclical Capital Buffer Proposal

The Basel Committee on Banking Supervision (the "BCBS") issued a consultative document regarding its proposal for a countercyclical capital buffer (the "Proposal"). The Proposal provides that a buffer would be "deployed when excess aggregate credit growth is judged to be associated with a build-up of system-wide risk to ensure the banking system has a buffer of capital to protect it against future potential losses." Accordingly, such countercyclical capital buffers are expected to be deployed in a given jurisdiction only on an infrequent basis, "perhaps as infrequently as once every 10 to 20 years." In general, national bank regulators would inform banks 12 months in advance of their judgment of any necessary "buffer add-on" in order to give banks time to meet the additional capital

requirements, while reductions in a buffer would take effect immediately to help reduce the risk that the supply of credit would be constrained by regulatory capital requirements.

Under the Proposal, internationally active banks would look at the geographic location of their credit exposures and calculate their buffer add-on for each exposure on the basis of the buffer in effect in the jurisdiction in which the exposure is located. (In other words, an internationally active bank's buffer would effectively be equal to a weighted average of the buffer add-ons applied in jurisdictions to which it has exposures.) Accordingly, internationally active banks "will likely find themselves carrying a small buffer on a more frequent basis, since credit cycles are not always highly correlated across the jurisdictions to which they have credit exposures." The Proposal also notes that the BCBS is continuing to consider the home-host aspects of the Proposal.

Methodology

To assist the relevant national banking regulators in each jurisdiction in making buffer decisions, the BCBS developed a methodology to serve as a common starting reference point. The methodology "transforms the aggregate private sector credit/GDP gap into a suggested buffer add-on," with a zero guide add-on when credit/GDP is near or below its long-term trend and a positive guide add-on when credit/GDP exceeds its long term trend by an amount which suggests there could be excess credit growth. The BCBS noted, though, that national authorities are not expected to rely mechanistically on the credit/GDP guide, but rather are expected to apply judgment in the setting of the buffer in their jurisdiction after using the best information available to gauge the build-up of system-wide risk.

Public Comment

The BCBS is accepting comments on the Proposal until September 10, 2010.

Other Action

The BCBS also announced in a press release that it will be presenting to the Central Bank Governors and Heads of Supervision at an upcoming meeting later in July concrete recommendations for the definition of capital, the treatment of counterparty credit risk, the leverage ratio, the conservation buffer and the liquidity ratios. In addition, the BCBS announced that it reviewed proposals for the role of "going concern" contingent capital and will issue shortly a proposal for consultation. Furthermore, the press release notes that the BCBS continues to review specific proposals to address the risks of systemic banking institutions, including a "guided discretion" approach for a systemic capital surcharge in combination with other mitigating regulatory and supervisory measures.

SEC to Consider New Mutual Fund Distribution Fee Rule and Form ADV Part 2 Amendments at Open Meeting

At its open meeting on Wednesday, July 21, 2010 at 10:00 a.m., the SEC is scheduled to consider whether to propose for public comment a new rule and rule and form amendments under the Investment Company Act of 1940, the Securities Act of 1933, and the Securities Exchange Act of 1934, that address the manner in which registered open-end management

investment companies ("funds") pay for distribution. As described in the notice of the open meeting, "[t]he recommended proposal would provide a new framework for how funds currently use their assets to pay for sales and distribution expenses pursuant to rule 12b-1 under the Investment Company Act, and would revise disclosure requirements for transaction confirmations pursuant to rule 10b-10 under the Securities Exchange Act."

The SEC will also consider whether to adopt amendments to Form ADV Part 2, which is part of the registration form for registered advisers and dictates the information about a registered adviser's services, personnel, business practices, fees and conflicts of interest that must be provided to new clients and made available to existing clients on an annual basis. The amendments would replace Form ADV Part 2's current check-the-box approach with a list of disclosure requirements that advisers would follow to produce a narrative brochure in plain English. The amendments would require advisers to file their brochures electronically with the SEC, which would make them publicly available on its website. The amendments would complete an overhaul of Form ADV that began in 2000 with the adoption of changes to Form ADV Part 1, which included electronic filing. The SEC deferred final action on Part 2 amendments, which were most recently re-proposed in 2008 (as discussed in the April 22, 2008 *Alert*).

FinCEN Publishes Assessment of Amendments to CTR Exemption Rules

The U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") published an assessment (the "Assessment") of the impact of recent amendments to its currency transaction report ("CTR") rules. The CTR rule amendments, which were effective on January 5, 2009 and described in the December 9, 2008 *Alert*, amended CTR requirements for depository institutions by streamlining the reporting process and easing the requirements for depository institutions to benefit from exemptions with respect to certain types of customers and transactions.

In the Assessment, FinCEN concluded that the rule amendments have had positive effects. The overall number of designation of exempt person ("DOEP") filings has declined 44%, primarily due to the fact the DOEP filings are no longer necessary when the subject is a bank, government agency, or governmental authority. In addition, FinCEN noted that initial DOEP filings for other types of customers where such filings are still necessary grew by 41.7% in 2009, indicating that many institutions were taking advantage of the new streamlined exemption process for such customers. Finally, FinCEN found that the CTR exemption amendments helped reduce the overall volume of CTR filings by 12% in 2009, suggesting that fewer CTR were being filed regarding transactions of limited or no use to law enforcement.

Banking Agencies Issue Statement to Assist Financial Institutions and Their Customers Affected by Gulf of Mexico Oil Spill

The FRB, FDIC, OCC, OTS, NCUA and the Conference of State Bank Supervisors (the "Agencies") jointly issued a statement (the "Statement") to assist financial institutions ("FIs") and their customers affected by the explosion and oil spill related to the Deepwater Horizon Mobile Offshore Drilling Unit in the Gulf of Mexico (the "Gulf Oil Spill").

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PARTNERS AND COUNSEL

Marco E. Adelfio
Lynne B. Barr
Raymond P. Boulanger
John J. Cleary
Daniel T. Condon
Margaret B. Crockett
James S. Dittmar
Anna E. Dodson
Alison V. Douglass
Eric R. Fischer
James O. Fleckner
Elizabeth Shea Fries
Lynda T. Galligan
Jackson B.R. Galloway
Stuart M. Glass
Mark Holland
John Hunt
James J. Kelly
Robert G. Kester
Robert M. Kurucza
Thomas J. LaFond
Paul W. Lee
William P. Mayer
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Mark S. Raffman
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Derek N. Steingarten
William E. Stern
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Scott A. Webster
Michael P. Whalen

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The Statement encourages FIs to assist their borrowers affected by the Gulf Oil Spill. Efforts taken by FIs to assist such customers, if taken in a reasonable and prudent manner, will be considered "safe and sound" by the Agencies. The statement identifies the following alternatives that FIs may consider using in assisting customers affected by the Gulf Oil Spill:

(1) "Temporarily waiving late payment charges, ATM fees, and penalties for early withdrawal of savings;

(2) Expediting lending decisions when possible, consistent with safety and soundness;

(3) Extending or restructuring borrower debt obligations in anticipation of the receipt of funds based on claims the borrower may have filed with BP p.l.c.; and

(4) Easing credit terms or fees for loans to certain borrowers, consistent with prudent banking practice."

Although encouraging FIs to work with customers affected by the Gulf Oil Spill, and although the Agencies confirm that they will consider the difficult position of FIs affected under these circumstances, the Agencies state that they will expect FIs to: (i) appropriately recognize credit losses as soon as a loss can be reasonably estimated; (ii) preserve the integrity of the FI's internal loan grading methodology; (iii) maintain appropriate accruals and reserves on affected credit; and (iv) maintain adequate capital ratios or, if unable to do so, develop a satisfactory capital restoration plan.

OTHER ITEMS OF NOTE

SEC's Division of Corporation Finance Adds Specialized Offices Focusing on Large Financial Institutions, Structured Finance Products and Securities Offering Trends

The SEC's Division of Corporation Finance is creating three specialized offices that will focus on (a) enhancing the Division's existing program for reviewing periodic reports filed by large financial institutions, (b) disclosure review and interpretive and rulemaking activities for asset-backed securities and other structured products, and (c) evaluation of securities offering trends.

FinCEN Extends Deadline for Comments on Proposed Rules for Providers and Sellers Prepaid Access

FinCEN extended the deadline for comments on its proposed rules for providers and sellers of prepaid access until August 27, 2010. The proposed rules, which were discussed in the June 29, 2010 *Alert*, would expand the anti-money laundering obligations of providers and sellers of prepaid access. The original deadline for comments had been July 28, 2010.