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DEVELOPMENTS OF NOTE

SEC Staff Grants No-Action Relief with Respect to Purchase by Mutual Funds of Loan Participations

The staff of the Division of Investment Management (the “Staff”) issued a [no-action letter](#) stating that it would not recommend enforcement action for violations of Section 10(f) of the Investment Company Act of 1940, as amended (the “1940 Act”), against certain registered investment companies (each a “Fund” and collectively, the “Funds”) if they purchase certain loan assignments and participations (each a “Participation” and collectively, the “Participations”) in a primary offering, when a Fund director (the “Director”) is an independent director of a participant (the “Principal Underwriter”) in an underwriting or selling syndicate for the offering. Section 10(f) of the 1940 Act, with certain limited exceptions, prohibits a registered investment company from purchasing any security during the existence of any underwriting or selling syndicate, when a director of the company is an affiliated person of a principal underwriter.

The Director. In the request for relief, the Funds represented that the Director is “independent” of the Funds’ investment adviser, subadvisers and their respective affiliates (collectively, the “Advisers”), but is an “interested person” of the Funds and the Advisers because the Director serves as an independent director of the Principal Underwriter, which may provide brokerage services to, and engage in principal transactions and lending relationships with the Funds or other funds or accounts of the Advisers.

The Principal Underwriter. The Funds represented that the Principal Underwriter, which has a significant presence in the placement of loan assignments and participations, is not an affiliated person of the Funds or the Advisers.

Section 10(f). The Funds asserted that there is some uncertainty as to whether Section 10(f) is applicable to Participations contending, among other things, that although offerings of Participations resemble underwritings or selling syndicates in certain respects, the offering process for Participations does not constitute an “underwriting” within the meaning of the Securities Act of 1933 (the “1933 Act”) because a Participation is not a security under the 1933 Act. Without conceding the applicability of Section 10(f), the Funds proposed to follow certain conditions (the “Conditions”) modeled on those in Rule 10f-3 under the 1940 Act. Rule 10f-3 exempts from the Section 10(f) prohibition the purchase of certain types of securities, including (i) securities that are registered under the Securities Act of 1933 and (ii) securities that are exempt from such registration pursuant to Rule 144A of the 1933 Act, provided certain conditions regarding purchase time and price and certain conditions regarding the issuer are met.

Among other things, the Conditions require that the Boards of the Funds, including a majority of the directors who are not interested persons of the Funds, (i) will approve procedures governing the purchase of a Participation by a Fund, that are reasonably designed to provide that the purchases comply with timing, price and commission Conditions; (ii) will approve such changes to the procedures as they may deem necessary; and (iii) will determine no less frequently than quarterly that all purchases of Participations made during the preceding quarter were effected in compliance with the foregoing procedures. The Director will recuse himself from any voting matters related to purchases of the Participations, including ensuring compliance with the Conditions. Each Fund will maintain and preserve, in an easily accessible place, (i) written copies of procedures related to the purchase of any Participations and (ii) a written record of each such transaction that demonstrates satisfaction of the Conditions.

Goodwin Procter represented the Funds in this matter.

Banking Agencies Issue Frequently Asked Questions Concerning Interest Rate Risk Management

The FRB, FDIC, OCC, NCUA and the State Liaison Committee (the “Agencies”) jointly issued [frequently asked questions](#) (“the FAQs”) concerning interest rate risk (“IRR”) management. The FAQs update the Agencies’ January 7, 2010 advisory concerning management of IRR by federally insured depository institutions (“institutions”), discussed in the [January 12, 2010 Financial Services Alert](#). The FAQs clarify the Agencies’ position on IRR modeling, reminding institutions to ensure that their IRR assessment processes match their individual risk profiles. The FAQs are divided into sections on risk management and oversight, measurement and monitoring of IRR, stress testing, internal controls and validation, and assumptions.

The FAQs state that institutions must model the risks posed by interest rate changes on both earnings and the economic value of capital, over various time horizons, to ensure that they capture the full spectrum of IRR. Longer time horizons should be considered; a minimum two-year period is recommended, since many risks may not show up in a one-year

projection. While community institutions are not required to perform longer-term, five-to-seven year simulations, risk managers may find them helpful in understanding the total IRR picture. While regulators may allow institutions with non-complex balance sheets to employ alternative, less sophisticated measurement processes on a case-by-case basis, all institutions are encouraged to employ earnings simulations, which technology has made increasingly available.

The FAQs note that stress scenarios should generally include rate shocks greater than ± 300 basis points. Measuring the potential effects of extreme shocks can be very helpful for risk managers. The appropriate scenarios depend on market conditions: for instance, simulations of a +400 basis point shock may be especially useful in a period of extremely low rates, while simulations of a large negative shock would be less valuable.

The FAQs state that IRR models should include scenarios for repricing mismatch, basis risk, yield curve risk, and options risk. While the exact scenarios will vary based on an institution's unique risks, most analyses should be run at least annually. For institutions particularly sensitive to one of those risks, the appropriate model for that risk should be run monthly or quarterly.

The FAQs remind institutions that evaluations of new products and strategies must include due diligence of all risks, including IRR. An institution must adjust its IRR models as necessary to account for unique risks posed by any new products.

Should an institution offer any complex and structured products, the FAQs remind the institution to model carefully all embedded loan options that can affect IRR. Relevant attributes include reset dates, reset indices and margins, embedded caps and floors, and any prepayment penalties.

The FAQs further emphasize that institutions that rely on third-party vendor models for measuring IRR risk are responsible for independently verifying the model's accuracy and appropriateness to the institution's own risk profile. Model certifications and validations commissioned by vendors will rarely completely satisfy supervisory expectations. In evaluating third-party models, an institution must take into account how well the model handles any highly structured instruments or unique products it offers. Moreover, the institution must ensure it has adequate in-house knowledge if there is a lapse in vendor support.

The FAQs state that assumptions made by institutions should be appropriate to the individual institution, which generally means that industry estimates and default third-party assumptions are inadequate. However, some institutions may not have systems in place to accurately measure certain data points, such as non-maturity-deposit decay rates. In such a case, an institution may use industry estimates as a starting point, while working to develop internal data and taking into account ways in which the industry estimate may be inappropriate to the individual institution—for instance, because of inconsistency in customer behavior across geographic areas.

Finally, at the end of the FAQs, the Agencies provide an appendix with links to prior bank regulatory guidance on IRR management and related matters.

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CFTC Approves Final Collateral Segregation Rule

The CFTC approved a [rule](#) requiring Futures Commissions Merchants (FCMs) and Derivatives Clearing Organizations (DCOs) to segregate collateral belonging to parties trading in cleared swaps. The rule, approved on Wednesday, permits FCMs and DCOs to commingle customer collateral in the same accounts, but prohibits them from commingling customer collateral with their own funds. It also requires FCMs and DCOs to track the changes in value of each customer's collateral, individually, and prohibits them from tapping a non-defaulting customer's collateral to cover another customer's losses.

The CFTC adopted this approach after considering a more stringent alternative that would have required each customer's collateral to be kept in a separate account, as well as two other alternatives that would have permitted the collateral of non-defaulting customers to cover other customer's losses under certain circumstances. All four alternatives are discussed in the CFTC's [Advanced Notice of Proposed Rulemaking](#).

The new rule applies only to swaps, not to futures. For futures, the collateral of non-defaulting customers still may be used to cover losses of other customers. This dichotomy was the subject of intense discussion among the CFTC Commissioners. Commissioner Jill Sommers argued that swaps and futures should be treated similarly; she rejected what she described as a "piecemeal approach" and cast the sole vote against the proposal.

OTHER ITEM OF NOTE

OCC Issues Interpretive Letter Confirming that OCC Lending Limit Rule Regarding Sale of Loan Participations Does Not Require that the Sale of Participations Qualify as a Sale under Applicable Accounting Standards

The OCC issued an [interpretive letter](#) (OCC Letter No. 1134), in response to a request from the Wisconsin Bankers Association, in which the OCC confirmed that a national bank's loan participations that satisfy the requirements of the OCC's lending limit rule regarding the sale of loan participations at 12 C.F.R. §32.2(k)(2)(vi), (and accordingly are not deemed loans or extensions of credit for lending limit purposes) will qualify for lending limit relief even though the sale of the loan participations does not meet the requirements for "sale" treatment under applicable accounting standards (as currently set forth in Financial Accounting Standards No. 166, which amended FASB Statement No. 140).

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