

FINANCIAL SERVICES ALERT

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DEVELOPMENTS OF NOTE

SEC Staff Grants No-Action Relief to Allow Money Market Funds to Hold Window Variable Rate Demand Notes

The staff of the SEC's Division of Investment Management (the "Staff") published a no-action letter regarding the treatment of window variable rate demand notes ("WVRDNs") under Rule 2a-7 under the Investment Company Act of 1940, the SEC rule that applies to registered open-end investment companies that operate as money market funds. According to the no-action request letter, a WVRDN typically is issued in series and each series has a long-term stated maturity (generally 30 years), with each series having an interest rate that generally is calculated as the sum of a floating base rate plus a spread. The interest rate is reset weekly (and thus, is a variable rate for Rule 2a-7 purposes). The spread may be increased from time to time with the agreement of the issuer. As represented in the no-action request letter, each WVRDN issuer must have at least an A-rating and the highest short-term rating. The no-action request letter claims that WVRDNs are expected to be used principally by municipalities wanting to access the variable rate market.

WVRDN's Dual Put Feature. As described in the no-action request letter, the key feature of a WVRDN is the "dual put" feature, which is intended to replace the traditional bond insurer support or credit or external bank support. Under the dual put feature, a holder has the right at any time to tender his note for purchase, giving the remarketing agent 30 days to find a buyer (the "remarketing window"). If the remarketing agent finds a buyer at the current spread, or at a higher spread acceptable to the issuer, the holder delivers his note and the sale is completed. (If the interest rate is based on a greater spread agreed to by the issuer, all WVRDNs of that series will receive the higher rate.) If the remarketing agent cannot find a buyer at the current spread, or at a greater spread acceptable to the issuer, the remarketing window closes at the end of the 30-day period. The closing of the remarketing window triggers an unconditional mandatory tender to the issuer of all WVRDNs, not just those notes voluntarily tendered to start the remarketing window, and the issuer generally

has up to one year (397 days from the date of the original voluntary tender) to purchase all WVRDNs (the “funding window”). If the issuer fails to purchase all WVRDNs before the close of the funding window, the issuer is in default under the note.

WVRDNs as Long-Term Variable Rate Securities. In the no-action request letter, the issuer characterized the WVRDN for Rule 2a-7 purposes as a “Long-Term Variable Rate Security,” that is, a variable rate security, the principal amount of which is scheduled to be paid in more than 397 calendar days, which is subject to a demand feature. (The primary purpose of the demand feature is to shorten a security’s maturity to comply with Rule 2a-7’s requirement that any security acquired by a money market fund must have a remaining maturity of 397 days or less.) Under Rule 2a-7(d)(3), a long-term variable rate security has a maturity that is the longer of (a) the period until the next interest reset date and (b) the period remaining until the principal amount may be recovered on demand.

Dual Put as Demand Feature. In the no-action request letter, the issuer asked the Staff whether it may treat the dual put feature as a demand feature for purposes of Rule 2a-7, and in response, the Staff said that it would not object. Under Rule 2a-7(a)(8)(i), a demand feature, among other things, “must be exercisable on no more than 30 calendar days’ notice” or “at specified intervals not exceeding 397 days.” With respect to WVRDNs, the no-action request letter stated that the dual put feature is consistent with Rule 2a-7(a)(8)(i), but noted that a question could be raised about the lack of any requirement that a WVRDN’s holder be paid by the conclusion of the 30-day remarketing window, even though the holder should be paid no later than the close of the funding window. The request letter argued that the 30-day notice requirement in Rule 2a-7 was intended primarily to address issues of fund portfolio liquidity and not the length of the notice period. The no-action request letter also noted the potential question as to whether the dual put feature qualifies as a demand feature by virtue of being exercisable at specified intervals and simply noted that the Staff had demonstrated some flexibility on this issue in response to other requests for no-action relief in this area. The Staff did not give any explanation for its no-action position or indicate whether it agreed or disagreed with the justifications in the request for relief.

FRB Issues Letter Approving Extension of Merchant Banking Investment

The Gramm-Leach-Bliley Act of 1999 (“GLBA”) created a special type of bank holding company, a financial holding company (“FHC”), and authorized it for the first time to passively invest in non-financial companies (“merchant banking investments”). The GLBA generally permitted an FHC to hold a merchant banking investment for up to ten years, subject to FRB approved extensions. As a result, if an FHC acquired and held a merchant banking investment shortly after and since the passage of the GLBA, at this point the FRB would have to either dispose of the merchant banking investment in the near future or ask for an extension from the FRB.

In an interpretive letter dated May 28, 2009 (the “Letter”), the FRB provided some insight into the factors it would consider when deciding whether an extension was appropriate. The Letter states that the applicant complied with the information requirements located at 12 CFR 225.272(b)(4). The FRB also considered the applicant’s average holding period for merchant banking investments, the efforts the applicant has made to dispose of the merchant banking investment at issue, the fact that the applicant has reduced the level of that merchant banking investment to a significant degree, and that the applicant has held the merchant banking investment in conformity with applicable rules, including restrictions on

routine management and operation of the company to which the merchant banking investment relates. On this basis, the FRB agreed to extend the period during which the applicant may hold the merchant banking investment.

IRS Temporarily Suspends the Broadening of FBAR Filing Requirements for “U.S. Persons”

The Internal Revenue Service (the “IRS”) on June 5, 2009 issued Announcement 2009-51 (the “Announcement”) to reduce confusion over the reporting requirements with respect to foreign bank accounts on Form TD F 90.22-1 (Report of Foreign Bank and Financial Accounts), commonly referred to as “FBAR.” The Announcement indicates that the IRS is temporarily suspending those reporting requirements for upcoming FBAR filings – due on June 30, 2009 (covering the 2008 calendar year) – for those persons who are not citizens, residents, or domestic entities. The confusion was a result of a changed definition that would have applied to, and ultimately broadened, the upcoming June 30 filing obligation.

The FBAR filing rules require that each U.S. person who has a financial interest in or signature or other authority over any foreign financial accounts, including bank, securities, or other types of financial accounts, in a foreign country, if the aggregate value of these financial accounts exceeds \$10,000 at any time during the calendar year, report that relationship each calendar year by filing TD F 90-22.1 with the Department of the Treasury on or before June 30 of the succeeding year. FBARs are under increased scrutiny due to the U.S. Government’s crackdown on the holders of offshore accounts who may have failed to pay U.S. taxes.

Form TD F 90.22-1 was revised in October 2008 with several changes, including a change to the definition of “U.S. person.” That revision broadly defined a “U.S. person” as a citizen or resident of the U.S., or a person in and doing business in the U.S.

However, due to comments, concerns, and questions from the public, the IRS reinstated a prior set of FBAR instructions (the July 2000 version). Importantly, this technical reversion to the prior instructions only applies to the issue of whether a person has an obligation to file an FBAR. Under the prior version of the form, a U.S. person is defined as a (1) citizen or resident of the U.S.; (2) a domestic partnership; (3) a domestic corporation; or (4) a domestic estate or trust. This change will smooth the FBAR filing process for June 30, 2009 by allowing all persons to rely on the narrower definition of “U.S. person” found in the instructions for the prior version of the FBAR (the July 2000 version).

All other requirements of the current version of the FBAR form and instructions (revision dated October 2008) are still in effect. Moreover, the current version of the form must be used when filing a FBAR. The Announcement indicates that the IRS will issue future guidance with respect to FBARs due in later years.

FinCEN Proposes Changes Requiring Mutual Funds to File CTRs

The Financial Crimes Enforcement Network (“FinCEN”) issued a proposal (the “Proposal”), which, if adopted, would “streamline” the Bank Secrecy Act (“BSA”) filing requirements applicable to mutual funds that receive greater than \$10,000 in currency.

Mutual funds currently file IRS/FinCEN Form 8300 - *Report of Cash Payments Over \$10,000 Received in a Trade or Business* (“Form 8300”) for the receipt of more than

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\$10,000 in “currency.” This filing requirement applies to the receipt of not only cash and coins, but also cashier’s checks, bank drafts, traveler’s checks and money orders in face amounts of \$10,000 or less.

The Proposal, if adopted, would require mutual funds to file FinCEN Form 104, *Currency Transaction Report* (“CTR”) rather than Form 8300 for the receipt of more than \$10,000 in currency. For the purposes of the CTR filing requirement, “currency” is defined to include coin and cash, but not cashier’s checks, bank drafts, traveler’s checks, money orders, and other similar monetary instruments. The ultimate result of the Proposal, if adopted, is that mutual funds would be freed from having to report certain transactions involving monetary instruments.

Comments on the Proposal are due by September 3, 2009.

FDIC Updates Status of the Legacy Loans Program

The FDIC announced that development of the Legacy Loans Program (“LLP”) will continue, but that a previously planned pilot sale of assets by open banks will be postponed. The LLP is the portion of the Public-Private Investment Program that is intended, through the provision of FDIC debt guarantees and possibly Treasury equity co-investment, to attract private capital to purchase real estate loans that banks currently hold on their balance sheets. For a further discussion of the LLP, please see the [March 24, 2009 Alert](#). In making the announcement, FDIC Chairman Sheila Bair stated, “Banks have been able to raise capital without having to sell bad assets through the LLP, which reflects renewed investor confidence in our banking system. As a consequence, banks and their supervisors will take additional time to assess the magnitude and timing of troubled assets sales as part of our larger efforts to strengthen the banking sector.” As a next step, the FDIC will test the funding mechanism contemplated by the LLP in a sale of receivership assets this summer. The FDIC expects to solicit bids for this sale of receivership assets in July 2009.