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In this Issue:

Developments of Note

- FFIEC Issues Statement on Regulatory Conversions
- Treasury, FRB and FDIC Provide PPIP Update; Legacy Securities Program Asset Managers Announced
- SEC Proposes Enhanced Compensation and Corporate Governance Disclosure Requirements
- FDIC Issues FAQs Regarding New Sweep Account Disclosure Requirement
- U.S. Court of Appeals for D.C. Circuit Upholds OTS Anti-Takeover Rule
- Federal Banking Agencies Issue Guidance Stating that Financial Institutions Should Use 20 Percent Risk Weighting for Warrants Issued by California
- Massachusetts Division of Banks Releases Report Concerning Foreclosure and Mortgage Lending Issues in Massachusetts

DEVELOPMENTS OF NOTE

FFIEC Issues Statement on Regulatory Conversions

The Federal Financial Institutions Examination Council (the "FFIEC") released a statement emphasizing that financial institutions should only undertake charter conversions or applications to change their primary federal regulator for legitimate business and strategic reasons. The FFIEC, in responding to concerns that the opportunity for charter conversions could be used to avoid current or prospective supervisory actions, stated that financial institutions should not contemplate initiating conversion requests if material enforcement actions are pending.

The FFIEC reaffirmed the procedures currently in place to prevent abuse of the charter conversion system. Institutions intending to change their charter or banking supervisor must seek approval with the prospective chartering authority and primary federal regulator. If the financial institution's current supervisor has rated or has proposed to rate the institution a 3, 4, 5 (or "Needs to Improve" or "Substantial Noncompliance" with respect to CRA performance), or the current supervisor has instituted or plans to institute a serious or material corrective program with respect to the institution, the prospective chartering authority shall consult with the Federal Deposit Insurance Corporation (or the National Credit Union Administration when appropriate) and the Federal Reserve Board.

The FFIEC also stated that assigned ratings and outstanding corrective programs will remain in place following a charter conversion and/or supervisory agency change. The prospective supervisor will consult with the current supervisor to obtain information on any pending or outstanding supervisory actions before approving any conversion request,

including a summary of the existing examination program and any specific plans for ratings downgrades and enforcement actions. The prospective supervisor's initial examination and enforcement action program will follow the work of the existing supervisor. If the existing supervisor's examination is not recent, or if other circumstances warrant, the prospective supervisor can choose to conduct an eligibility examination and may invite the current supervisor to participate to help ensure continuity of supervision. The prospective supervisor will factor proposed ratings and enforcement actions into its examination planning process and fully assess the appropriateness of current or in-process ratings downgrades only after the completion of an appropriately-scoped on-site examination.

Treasury, FRB and FDIC Provide PPIP Update; Legacy Securities Program Asset Managers Announced

The Treasury, FRB and FDIC have released a joint update on the status of the Public Private Investment Program ("PPIP"). For a further discussion of the PPIP, please see the [March 24, 2009 Alert](#). As part of the update, the Treasury announced nine asset managers for the Legacy Securities Program (the "Program"):

- AllianceBernstein, LP and its sub-advisors, Greenfield Partners, LLC and Rialto Capital Management, LLC;
- Angelo, Gordon & Co., L.P. and GE Capital Real Estate;
- BlackRock, Inc.;
- Invesco Ltd.;
- Marathon Asset Management, L.P.;
- Oaktree Capital Management, L.P.;
- RLJ Western Asset Management, LP.;
- The TCW Group, Inc.; and
- Wellington Management Company, LLP.

These nine asset managers (the "Program Fund Managers") will establish public private investment funds ("PPIFs") to purchase "legacy securities" issued before 2009. Under the Program, the Treasury will invest up to \$30 billion of equity and debt in the PPIFs. The Program will initially target commercial mortgage-backed securities ("CMBs") and non-agency residential mortgage-backed securities. To qualify for purchase under the Program, these securities must have been issued prior to 2009 and have originally been rated AAA - or an equivalent rating by two or more nationally recognized statistical rating organizations - without ratings enhancement and must be secured directly by the actual mortgage loans, leases, or other assets ("Eligible Assets"). The Program Fund Managers have also established partnerships with small-, veteran-, minority-, and women-owned businesses. These partners will provide such services as asset management, capital raising, broker-dealer, investment sourcing, research, advisory, cash management and fund administration.

Each Program Fund Manager will have up to 12 weeks to raise at least \$500 million of capital from private investors, up to a total of \$10 billion for all of the LSP Fund Managers. Each Program Fund Manager will also invest a minimum of \$20 million of firm capital into the PPIFs. The equity capital raised from private investors will be matched by the Treasury up to \$10 billion. Any investor may invest in a PPIF, including sovereign-wealth funds and

foreign investors. Retail investors may also participate in PPIFs. At least one Program Fund Manager is planning to offer its PPIF to retail investors, both through public pension funds investors and directly through individual investors. No single investor may hold more than 9.9% of any one PPIF. Upon raising this private capital, Program Fund Managers may begin purchasing Eligible Assets. The Treasury will also provide up to \$20 billion in debt financing for the PPIFs. In addition, PPIFs will be able to obtain debt financing raised from private sources, and leverage through the Term Asset-Backed Securities Loan Facility (the "TALF"), for those assets eligible for that program, subject to total leverage limits and covenants.

The Program Fund Managers will have discretion to manage Eligible Assets; however, the Treasury stated that the PPIF's general investment orientation should center on long-term buy and hold strategies. The PPIFs must be operated by the Program Fund Managers for at least eight years, and the Program Fund Managers must provide the Treasury with monthly reports that include the price paid for each Eligible Asset. The Treasury has indicated that it will disclose the top 10 holdings for each PPIF, but has not decided whether to provide any additional information on the investments of the PPIFs. Program Fund Managers will be subject to conflict-of-interest rules developed by the Treasury in consultation with the FRB and the Special Inspector General of the Troubled Asset Relief Program. These rules, among other things, prohibit Program Fund Managers from purchasing Eligible Assets from their affiliates or from other Program Fund Managers.

The joint PPIF update also reiterated previously announced PPIF developments. The FRB noted that starting in July certain CMBs issued before January 1, 2009 will be eligible collateral under the TALF. The FDIC noted that it has suspended the Legacy Loan Program ("LLP"), but noted that it will test the LLP funding mechanism in a sale of receivership assets this summer. For more information on the status of the LLP, please see the [June 9, 2009 Alert](#).

SEC Proposes Enhanced Compensation and Corporate Governance Disclosure Requirements

The SEC voted to propose rule and form amendments that would expand compensation and corporate governance disclosure requirements for operating companies and investment companies, change the disclosure of shareholder voting results and clarify the operation of certain rules governing the proxy solicitation process. The compensation and corporate governance elements of the SEC's proposal are summarized below.

Compensation Disclosure. The SEC proposes to amend Regulation S-K ("Reg. S-K") under the Securities Exchange Act of 1934 (the "1934 Act") to expand the Compensation Discussion and Analysis required by Item 402 of Reg. S-K to include a new section that will provide information about how a company's overall compensation policies for employees create incentives that can affect the company's risk and management of that risk. The proposed amendments would also revise the presentation of stock awards and option awards under the Summary Compensation Table and Director Compensation Table required by Item 402.

Director and Nominee Disclosure. The SEC is proposing amendments to the director and nominee disclosure requirements of Item 401 of Reg. S-K. The proposed amendments would require disclosure for each director and nominee for director regarding the particular experience, qualifications, attributes or skills as of the time the particular filing is made that

qualify that person to serve as a director of the company, and as a member of any committee that the person serves on or is chosen to serve on (if known), in light of the company's business and structure. The types of information that the SEC expects might be disclosed in response to the proposed requirements include information about a director's or nominee's risk assessment skills and any specific past experience that would be useful to the company, information about a director's or nominee's particular area of expertise and why the director's or nominee's service as a director would benefit the company. The proposal would apply to incumbent directors, to nominees for director who are selected by a company's nominating committee and to any nominees put forward by other proponents.

The proposal would also require the disclosure of any directorships at public companies (including registered investment companies) held by each director or nominee at any time during the past five years. (Currently Item 401 only requires disclosure of current directorships.) The proposal would also modify Item 401 to expand from 5 to 10 years the period that must be examined to determine whether a director, executive officer or director nominee was involved in specified legal proceedings that are material to an evaluation of the ability or integrity of that person and should be disclosed. The expanded disclosure requirements regarding directors and nominees would apply to registered management investment companies ("funds") through modifications to the proxy and information statement disclosure requirements for funds regarding director elections and changes to statement of additional information disclosure requirements for registration statements on Forms N-1A, N-2 and N-3.

Leadership Structure and Board Role in Risk Management. The proposal would amend Reg. S-K and the proxy rules to require an issuer to describe its leadership structure and explain why it believes the structure is best for it at the time of the particular filing. The proposal would also add disclosure requirements regarding an issuer's combination or separation of the principal executive officer and board chair positions, an issuer's use of a lead independent director and the lead independent director's role. Proxy and information statements would need to discuss the board's role in a company's risk management process. Funds would be subject to additional requirements. In a proxy statement or information statement relating to a director election, a fund would also have to disclose whether its board chair is an "interested person" of the fund as defined in Section 2(a)(19) of the Investment Company Act of 1940 (an "interested person"). If a board chair were an interested person, the fund would be required to disclose whether it has a lead independent director and the specific role played by the independent director. Similar disclosure would be required in statements of additional information included in registration statements on Forms N-1A, N-2 and N-3.

Compensation Consultants. The SEC proposal would amend Item 407 of Reg. S-K to require disclosure about the fees paid to a compensation consultant and any of its affiliates that play any role in determining or recommending the amount or form of executive and director compensation and also provide other services to their company. The proposal provides an exception to situations in which a compensation consultant's only involvement in executive or director compensation is in connection with consulting on broad-based plans, such as 401(k) plans or health insurance plans, that do not discriminate in favor of the executive officers or directors of the company. This element of the proposal would not apply to funds.

Public Comment. Comments on the proposed amendments, which are available at <http://www.sec.gov/rules/proposed/2009/33-9052.pdf>, are due no later than 60 days after their publication in the *Federal Register*.

FDIC Issues FAQs Regarding New Sweep Account Disclosure Requirement

The FDIC issued FAQs regarding the new disclosure requirements for certain sweep accounts. Among other things, the FAQs clarify the types of sweep accounts subject to the disclosure requirements. The FAQs also clarify the timing of the required disclosures: for accounts in effect on July 1, 2009, the disclosures must be provided within 60 days after July 1, 2009 (*i.e.*, no later than September 1, 2009) and at least annually thereafter; and for accounts established after July 1, 2009, the disclosures must be provided at the time the sweep account agreement is entered into. Click [here](#) for the FAQs.

U.S. Court of Appeals for D.C. Circuit Upholds OTS Anti-Takeover Rule

The U.S. Court of Appeals for the District of Columbia Circuit (the “Court”) upheld a new OTS rule that allows mutual holding company subsidiaries to adopt charter provisions that limit any given minority shareholder to 10 percent of the subsidiary’s total minority stock (the “Charter Rule”). The Court found that the Charter Rule is “reasonable and reasonably explained.”

Joseph Stilwell, a private investor (whom the Court described as a regular buyer of minority stakes in mutual holding company subsidiaries) challenged the Charter Rule as arbitrary and capricious under the Administrative Procedure Act (the “APA”). Stilwell, who had also opposed the Charter Rule during the rulemaking process, asserted that the OTS failed to present empirical evidence justifying the Charter Rule and that the Charter Rule would aggravate the already existing problem of management granting itself lavish stock benefit plans.

The Court struck down Stilwell’s first argument regarding the OTS’s failure to present empirical evidence justifying the Charter Rule. The Court noted that the APA imposes no such obligation on agencies; rather, the agency must simply justify a rule it promulgates with a reasoned explanation. The Court stated that the OTS had satisfied this requirement. Specifically, the OTS had thoroughly explained that the Charter Rule was prompted by the agency’s concern that activist minority shareholders of mutual holding company subsidiaries could use (and were using) their leverage to take unfair advantage of voting rules that require a majority of minority shareholders to approve management stock benefit plans. In particular, the OTS was concerned that large minority shareholders would use their voting power pursuant to such rules in order to interfere in certain corporate governance areas, *e.g.*, by pressuring the mutual holding company to effect stock repurchases or a sale of the institution. Stilwell’s second argument similarly failed to pass muster with the Court since the Charter Rule does not affect the separate voting rules requiring a majority of minority shareholders to approve stock benefit plans. In this way, the Court stated that minority shareholders as a class continue to have the power to vote down stock benefit plans they consider ill-advised.

The Court concluded that the OTS “struck a permissible balance between the goals of deterring management’s self-dealing and preventing abusive short-term investment strategies.” In addition, the Court stated that, under the statutory scheme under which the OTS operates, the OTS has discretion “to balance the power of majority and minority

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shareholders in order to achieve [the OTS's] multiple regulatory objectives.” *Joseph Stilwell v. Office of Thrift Supervision*, Case No. 08-1259 (July 7, 2009). For the text of the Charter Rule, see Optional Charter Provision in Mutual Holding Company Structures, 73 Fed. Reg. 39,216 (July 9, 2008) (final rule).

Federal Banking Agencies Issue Guidance Stating that Financial Institutions Should Use 20 Percent Risk Weighting for Warrants Issued by California

The FRB, FDIC, OCC, OTS and NCUA (the “Agencies”) jointly issued guidance (the “Guidance”) to financial institutions (“FIs”) concerning the appropriate treatment of registered warrants (the “Warrants”) issued by the State of California. California, which is experiencing financial difficulties and has not yet adopted a budget, is issuing Warrants to pay for certain obligations. California has, for example, issued Warrants to pay individuals for income tax refunds, local governments for social services and vendors for goods and services. The Attorney General of California has opined that the Warrants are valid and binding obligations of California.

The Agencies state in the Guidance that since general obligation claims on a state receive a 20 percent risk weight for regulatory capital purposes, the Warrants will also receive a 20 percent risk weight. Moreover, the Guidance cautions that FIs must understand, manage and control the risks related to accepting and holding the Warrants, and “risk management practices should include evaluating the credit quality of the Warrants, establishing appropriate concentration limits and ensuring appropriate liquidity risk management.”

Separately, the SEC issued a release stating that the Warrants are “securities” for purposes of the federal securities laws and, thus, holders of Warrants are protected by the antifraud provisions of the federal securities laws in connection with the purchase or sale of the Warrants. The California Bankers Association said that California banks are not expected to accept Warrants after July 10, 2009.

Massachusetts Division of Banks Releases Report Concerning Foreclosure and Mortgage Lending Issues in Massachusetts

The Massachusetts Division of Banks (the “DOB”) issued a report entitled *Compendium of Actions Taken Relative to Foreclosures and the Mortgage Industry* (the “Report”), in which the DOB describes the administrative and legislative actions it has taken since 2006 to address foreclosure and mortgage lending issues in Massachusetts. The Report describes: (i) improved standards within the mortgage industry; (ii) enhanced supervision and enforcement (the Report states that since 2006, the DOB has issued 230 informal and 147 formal enforcement actions against licensed mortgage lenders and brokers); (iii) assistance programs for homeowners and (iv) improved state and local cooperation in addressing foreclosure and related mortgage industry issues. Click [here](#) for a copy of the Report.