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DEVELOPMENTS OF NOTE

OCC Issues Three Interpretive Letters Concerning Collective Investment Funds

The OCC released three interpretive letters concerning collective investment funds established pursuant to 12 C.F.R. § 9.18.

OCC Interpretive Letters 1119 and 1120

Interpretive Letters [1119](#) and [1120](#) are addressed to the same bank (the “Bank”), a trustee for index and model-drive collective investment funds established pursuant to 12 C.F.R. § 9.18. An affiliate (the “Affiliate”) of the Bank proposed to acquire a business that provided various fixed-income indices. The Bank requested confirmation that it would be permissible for the Bank to rely on the OCC’s determination set forth in OCC Interpretive Letters 1119 and 1120. In OCC Interpretive Letter [919](#) (issued in 2001), the Bank requested confirmation that it would be permissible for the Bank to rely on the OCC’s determination set forth in OCC Interpretive Letter 919 for ninety days following the acquisition of the index provider by the Affiliate. In Interpretive Letter 919, the OCC had stated that a bank may charge fees for admissions to and withdrawals from model-driven funds in the same manner and to the same extent as section 9.18 index funds, provided, in part, that the benchmark index the model-drive fund seeks to outperform is established and maintained by an independent organization. In Interpretive Letter 1119, a substantial percentage of the Bank’s model-driven funds were benchmarked to various indices maintained by the index provider to be acquired by the Affiliate. The Bank contended that the index provider should continue to be considered an independent business after the acquisition. The Bank represented that there were substantial information barriers between the Bank and Affiliate that would remain in place after the acquisition. The Bank committed that it would continue to operate in a manner completely separate from the index business, and noted that the index provider’s fixed income indices were widely followed benchmarks in the global debt market and were not specifically tailored for use by the Bank. The Bank fully expected the indices to continue to be maintained in a manner that

met the overall needs of the marketplace generally. The Bank also represented that the models used by the Bank would continue to use data not within the Bank's control for purposes of complying with the requirements of Interpretive Letter 919. The OCC concluded that the Bank's activities would not be inconsistent with Interpretive Letter 919 for the ninety-day period following the acquisition, and agreed to determine later whether the Bank could continue the activities after the ninety-day period.

In Interpretive Letter 1120, the OCC determined that the Bank could continue to charge fees for admissions and withdrawals from its model-driven funds benchmarked to an affiliated index, subject to certain limitations and conditions. Prior to the acquisition of the index provider by the Affiliate, the indices were widely used by institutional asset managers as benchmarks for fixed income index and model-driven collective investment funds, with approximately \$4 trillion in assets worldwide benchmarked to the indices, and the previous owner estimated that more than 90% of fixed income investors in the United States used the indices as a benchmark. According to the Bank, there was currently no unaffiliated index of a caliber equivalent to certain of the affiliated indices. The Bank contended that it is not necessary for an index provider to be unaffiliated with or structurally independent of the Bank for the OCC to conclude it was permissible for the Bank to allocate costs for admissions and withdrawals. The Bank argued that the OCC did not impose this requirements on index funds, and that the rationale for permitting the allocation of costs, which in the Bank's view was the equitable treatment of participants in the funds, was the same as that for index funds. The Bank also contended that the critical conditions, on which the interpretation in Interpretive Letter 919 rested, were that the allocation of costs must be authorized by the governing documents of the fund, that the index or benchmark must be a standardized index of securities that is not specifically tailored for the use of the fund manager and that the model must be based on prescribed objective criteria using independent third party data that is not within the control of the fund manager. The Bank represented that it was and would continue to be in compliance with these conditions, and believed these conditions were sufficient to ensure that the Bank is properly motivated to act fairly and in the interests of participants. In addition, the Bank agreed to comply with additional safeguards to ensure the indices could not be manipulated or controlled by the Bank. First, the affiliate index would be a separate business unit within the bank holding company organization, and the Bank would not exercise direct or indirect control over any affiliated index provider. Second, there would be an effective information barrier between the Bank and any affiliated index provider, such that the bank would not be provided access to non-public information regarding rules, decisions and data underlying the indices before such information is provided to third parties. Third, the Bank would not have a preferential ability over similarly situated managers to influence the methodology of an affiliated index. Finally, to the extent the Bank based its model-driven strategies on the products of an affiliated index provider, it would only use indices also available to unaffiliated institutional asset managers to benchmark funds.

The OCC noted that the purpose of requiring an independent third party index provider "was to ensure that the indices used as benchmark's for the Bank's model driven funds were not within the control of, or subject to manipulation by, the Bank's model-drive fund managers." The OCC stated, "we believe this purpose can be achieved by appropriate arrangements even where an affiliate of the Bank owns and maintains the benchmark indices. We further believe the Bank's commitments and representations provide such appropriate arrangements." For these reasons, the OCC determined that the Affiliate would not be within the control of the Bank and therefore deemed it "independent" consistent with Interpretive Letter 919. In addition to the conditions and commitments described above, the

OCC also required the Bank to notify its Examiner in Charge in writing if it decides in the future to use other indices owned and controlled by the Affiliate as benchmarks for its model driven funds. Although the Bank requested that the OCC make the determination in Interpretive Letter 1119 permanent with respect to its Affiliate's ownership of the index provider and with respect to any index provider that hereafter may be owned or controlled by an affiliate of the Bank, the OCC's determination was limited to the Bank's use of the indices that were acquired by its affiliate in connection with the September 2008 acquisition.

OCC Interpretive Letter 1121

In Interpretive Letter [1121](#), a bank that served as trustee for a collective investment fund (the "Fund") that invested in commercial real estate requested a waiver from 12 C.F.R. § 9.18(b)(5)(iii), which provides that a collective investment fund invested primarily in real estate or other assets that are not readily marketable may require a prior notice period, not to exceed one year, for withdrawals. The OCC has previously determined that this provision requires payment of such withdrawal requests within the one-year notice period. At the time of the request, the Fund had pending redemption requests representing over 20% of the total interests in the Fund. Due to the size of the pending redemption requests and current economic and market conditions, including unusual illiquidity in the commercial real estate market, the bank had determined that there would not be sufficient cash available to meet all pending redemption requests within the one-year period, and requested a waiver pursuant to 12 C.F.R. § 9.18(c) to permit a longer redemption period for the Fund. The bank contended that requiring it to meet the one-year redemption period would either force a fire sale of the Fund's real estate assets or an in-kind distribution of those assets to withdrawing participants, neither of which would be in the best interests of the Fund's participants. The bank contended that applicable fiduciary standards weighed against selling the assets at fire sale prices, and that an in-kind distribution would not benefit withdrawing participants because it would provide them not with cash, but with an illiquid asset, and would also create significant ERISA, tax, and valuation issues that would increase transaction costs.

In recent years, the OCC has concluded that national banks and other institutions that must comply with Section 9.18 to receive favorable tax treatment may restrict admissions and withdrawals for certain illiquid funds if they have valid reasons for doing so and the admissions and withdrawal policies are consistent with fiduciary duties. The OCC permitted an extended redemption period in this case, provided that the bank meets the following criteria: (1) the Fund's Declaration of Trust must clearly authorize a redemption period of more than one year; (2) the Fund's redemption policy, including the extended redemption period, must be fully disclosed to participants; (3) the bank must have valid reasons for an extended redemption period, and it must be necessary given the nature of the assets; (4) the bank must determine that an extended redemption period is consistent with fiduciary principles and in the best interests of all participants, both withdrawing and remaining; and (5) participants in the Fund must be limited to those who meet the definition of "institutional investors" and that are tax exempt retirement, profit sharing, or stock bonus plans administered by a trustee or a board of trustees. The bank represented that it met all the criteria. The OCC also required the bank to provide quarterly status reports to the Examiner-In-Charge detailing its efforts to satisfy pending redemption requests.

FinCEN Issues Guidance on Determining Eligibility for Exemption from Currency Transaction Reporting Requirements

The Financial Crimes Enforcement Network (“FinCEN”) issued [guidance](#) (the “Guidance”) regarding the rules which permit banks to treat certain customers as exempt from currency transaction report (“CTRs”) requirements. The Guidance provides background and responds to frequently asked questions regarding FinCEN’s December 2008 amendments to the CTR exemption rules (the “2008 Amendments”), which were described in the [December 9, 2008 Alert](#).

In its background section, the Guidance notes that the changes to the CTR rule’s exemption requirements were prompted by a 2008 General Accountability Office Report that recommended amendments to ease banks’ reporting burden while maintaining law enforcement efforts. The background section also sets forth an overview of the 2008 Amendments’ key substantive changes and provides a chart outlining the exemption requirements for each category of eligible customer.

The Guidance responds to frequently asked questions regarding the following issues:

- *Timing of Risk-Based Determination.* Under the 2008 Amendments, a bank may designate an eligible nonpublic company or payroll customer as exempt in less than two months if the bank conducts a risk-based analysis on the legitimacy of the customer’s transactions. The Guidance provides representative examples of customers where designation as exempt in less than two months may be appropriate: (1) returning customers that reopen a previously maintained exempt transaction account and (2) customers whose exempt status has changed (*e.g.*, a publicly listed company that goes private). FinCEN notes that, in each of the examples, there is some factor that enables that bank’s level of knowledge to exceed what is typical for a new customer being considered for an exemption.
- *Frequency of Transactions.* The 2008 Amendments lowered the threshold for exempting nonpublic businesses conducting “frequent” large cash transactions from eight transactions per year to five. The Guidance clarifies that a bank cannot exempt such a customer prior to the two month mark if the customer has not yet conducted five transactions involving \$10,000 or more in currency. The risk-based approach provides banks with flexibility with respect to the timing of an exemption designation, but each of the other exemption requirements must be met as required by the CTR rules.
- *Corporate Structure and Reorganization.* The Guidance responds to several questions regarding the impact of corporate structure and/or reorganization on a customer’s eligibility for exemption. First, the Guidance explains that a bank must reevaluate whether a customer that was previously a listed public company remains eligible for exemption under the rules’ criteria for nonpublic companies if the company is reorganized as a private company. In addition, the Guidance clarifies that the exemption available to certain subsidiaries of public companies does not apply to franchises or other affiliated entities when the listed company does not have a 51% or greater ownership interest in the franchise or other affiliated entity, even if the franchise operates under the same name as the public company. The Guidance also specifies that, using a risk-based approach, a bank must consider evidence of a customer’s business restructuring as part of its annual review or ongoing customer due diligence to

determine whether the restructuring makes the customer ineligible for exemption or makes the bank's designation of exempt person ("DOEP") form regarding the customer inaccurate or incomplete.

- *Customers No Longer Eligible for Exemption.* The Guidance explains that if a bank, during its annual review of a listed business or eligible nonpublic company or payroll customer, discovers that the customer no longer meets all criteria to remain exempt, the bank should document its determination of ineligibility and cease to treat the customer as exempt. While future large cash transactions by the customer must be reported, the bank does not need to back file CTRs regarding transactions by a previously eligible customer if the customer is later found to be ineligible by the bank in a timely annual review.
- *Suspicious Activity of an Exempt Customer.* In response to a question regarding whether a customer that has been the subject of a Suspicious Activity Report ("SAR") remains eligible for exemption from CTR filings, the Guidance states that a bank is not required to stop treating the customer as exempt solely based on the fact that the SAR was filed. The Guidance explains that the decision to treat a customer as exempt should be made in accordance with the bank's risk-based anti-money laundering policies, procedures, and controls.
- *Exemptible Transaction Accounts.* The Guidance specifies that the 2008 Amendments did not change the CTR rules' requirement that eligible nonpublic companies and payroll customers are exempt "only with respect to transactions conducted through its exemptible accounts." In determining whether a transaction qualifies for exemption, FinCEN explains that banks generally may consider whether a transaction results in a line item entry into the customer's transaction account statement. For example, if a convenience store customer that the bank treats as an exempt nonpublic company uses more than \$10,000 in currency to obtain a cashier's check from the bank, the bank must file a CTR if the transaction is processed through the bank's general ledger account. On the other hand, the bank does not need to file a CTR if the transaction is processed through a deposit to and debit from the convenience store's transaction account.

The Guidance also responds to questions regarding (a) how banks should complete the DOEP form, which has not been updated since the 2008 Amendments were updated; (b) whether a bank must formally revoke a DOEP filing regarding a customer that is no longer exempt; and (c) the scope of businesses that are ineligible for exemption because they are engaged in "the practice of medicine."

FASB Proposes Updates to Fair Value Disclosures

The Financial Accounting Standards Board ("FASB") proposed [an accounting standards update](#) that would amend U.S. generally accepted accounting principles (GAAP) disclosure requirements related to the Fair Value Measurements and Disclosures-Overall Subtopic (Subtopic 820-10) of the *FASB Accounting Standards Codification*, originally issued as FASB Statement No. 157, *Fair Value Measurements*. The update would require new disclosure regarding (a) the effect of reasonably possible alternative inputs on a Level 3 fair value measurement if they would change the measurement significantly (sensitivity disclosures) and (b) significant transfers into and/or out of Levels 1 and 2 and the reasons for the transfers. In addition, under the update, for Level 3 fair value measurements, information about changes due to purchases, sales, issuances and settlements would be

presented separately rather than on a gross basis. The proposed update would also revise Subtopic 820-10 to clarify (1) the requirements for an issuer's determinations regarding the appropriate classes of assets and liabilities as to which it will make required disclosures concerning its fair value measurements and (2) the disclosures required concerning the valuation techniques and inputs for fair value measurements that fall in Level 2 or Level 3. The update proposes that the amendments become effective for interim and annual reporting periods ending after December 15, 2009, except for sensitivity disclosures, which would be required for interim and annual reporting periods ending after March 15, 2010. Comments on the update are due to FASB by October 12, 2009.

ERISA Stock Drop Claims Dismissed Against Citigroup Where Plan Mandated Investment in Sponsor Stock

On August 31, 2009, Judge Sidney Stein of the United States District Court for the Southern District of New York dismissed entirely at the pleadings stage a consolidated putative class action against Citigroup, Inc. ("Citigroup"), its former CEO, Charles O. Prince, and numerous Citigroup directors, officers, employees and related entities in *In re Citigroup ERISA Litigation*, No. 1:07-cv-09790-SHS, 2009 WL 2762708 (S.D.N.Y. Aug. 31, 2009). The consolidated class action had been brought under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), by current and former employees of Citigroup who participated in one of two Citigroup 401(k) plans. The complaint alleged that the defendants breached their fiduciary and co-fiduciary obligations principally by (1) allowing investment through the 401(k) plans in the sponsoring corporation's stock when the price declined 52% from January 1, 2007 to January 15, 2008; (2) not providing complete and accurate information to the plans' participants—particularly with respect to the sponsoring corporation's subprime loan exposure; and (3) operating while under an alleged conflict of interest.

Judge Stein rejected each of plaintiffs' claims in a 51-page opinion. He found that none of the defendants could have been acting as an ERISA fiduciary with respect to the plans' investments in the sponsoring corporation's stock because each of the plans "unequivocally required that Citigroup stock be offered as an investment option." The court held that such plan provisions deprived any of the defendants from acting with the requisite control over the plans' investments to be deemed to be a fiduciary under ERISA, and because ERISA expressly contemplates the holding of employer stock by certain plans, these plan provisions were consistent with ERISA. Further, the court rejected a view of liability that would have fiduciaries placed at risk every time they decided whether or not to override a plan's terms. The court provided an alternative ground for its dismissal by applying the presumption of prudence attaching to retirement plans' investment in the sponsoring employer's stock as set forth in *Moench v. Robertson*, 62 F.3d 553 (3d Cir. 1995), and finding that the complaint failed to allege sufficient facts to overcome this presumption where plaintiffs alleged a pattern of "risky loan practices" and investments in mortgage-related securities, but did not provide any indication that the sponsoring corporation's viability was threatened.

The court also found that defendants were not required by ERISA to provide financial information to participants about the sponsoring corporation because ERISA does not require retirement plan fiduciaries to give investment advice. The court held that ERISA fiduciaries did not have to provide material, non-public information to plan participants. Finally, the court held that no conflict of interest could be established simply from the pleaded allegation that (1) compensation of individual defendants was tied to the

performance of the sponsoring corporation's stock and (2) certain individual defendants sold the sponsoring corporation's stock during the putative class period. Other claims as to breach of co-fiduciary duties and alleged failure to monitor fiduciaries were also dismissed on the grounds that no underlying liability of any fiduciary was adequately pleaded.

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