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DEVELOPMENTS OF NOTE

FDIC Issues Notice of Proposed Rulemaking that Would Require Banks to Prepay Deposit Issuance Assessments for Three Years (through 2012)

On September 29, 2009, the FDIC adopted a Notice of Proposed Rulemaking ("NPR") that would mandate that insured depository institutions ("DIs" and each a "DI") prepay their quarterly risk-based assessments to the FDIC for the fourth quarter of 2009, and for all of 2010, 2011, and 2012 on December 30, 2009, when they pay their risk-based deposit insurance assessment for the third quarter of 2009. Further, the FDIC acknowledged that the Deposit Insurance Fund ("DIF") would be negative as of September 30, 2009. Under the plan announced by the FDIC, the DIF will not be solvent again until 2012, and will not reach its statutory reserve ratio of 1.15% until 2017. In addition to the negative balance of the DIF, the FDIC is also facing a more pressing need; the need for liquidity. If the FDIC takes no action regarding its liquidity needs, then the FDIC's projected liquidity needs will exceed its liquid assets in the first quarter of 2010.

In the short term, the proposed prepayment of assessments addresses the FDIC's liquidity needs. Although the FDIC can use the prepaid premiums to help pay resolution costs, the FDIC cannot immediately count such prepayments towards the DIF reserves. Under the proposed plan, each DI would record the entire amount of its prepayment as an asset (a prepaid expense). This is a benefit to DIs, which can count the payments as a depreciating asset, while the FDIC will have more liquid cash available for resolution costs.

Specifically under the NPR, the prepaid assessment base for each institution would be calculated using its third quarter 2009 assessment rate. That assessment base would then be adjusted quarterly with an estimated 5 percent annual growth in the assessment base through the end of 2012. The prepaid assessment rate for the fourth quarter of 2009 and for 2010 would be based on each DI's total base assessment rate for the third quarter of 2009, adjusted as if the assessment rate in effect on September 30, 2009 had been in effect for the entire third quarter. Further, the assessment rate for 2011 and 2012 would be equal to the adjusted third quarter 2009 total base assessment rate plus 3 basis points. As of December 31, 2009, and each quarter thereafter, each DI would record an expense for its regular quarterly assessment for the quarter and a corresponding credit to the prepaid assessment until the asset is exhausted. The FDIC will not refund or collect additional prepaid assessments because of a decrease or growth in deposits over the next three years. However, should the prepaid assessment not be exhausted by December 30, 2014, the remaining amount of the prepayment would be returned to the DI.

The NPR's prepayment proposal was made in lieu of other, possibly more extreme manners of raising funds by the FDIC; a special assessment on DIs or utilizing the FDIC's line of credit with the Treasury Department. The FDIC stated that it has not been the agency's intent to use this line of credit with the Treasury Department as a first source of funding; the line of credit is available in the event of an emergency or other unforeseen event that requires a large cash outflow. The FDIC also may be hesitant to use the line of credit for short term liquidity needs when other options are available because they would like to avoid the perception that the agency received a government bailout. Further, the prepayment of assessments is perceived as a better option than a special assessment of FDIC-insured institutions. The prepayment of assessments is expected to provide the FDIC with a cash infusion of about $45 billion, as opposed to about $5.5 billion that would be raised through a second special assessment. (In the second quarter of 2009, the FDIC levied a special assessment of 5 basis points per $100 of assets minus Tier 1 capital.) FDIC officials believe that the prepayment option is the most logical because failures are expected to peak this year and next. By 2011, the FDIC believes that industry earnings will be strong. Further, according to the FDIC, the banking industry has substantial liquidity to prepay the assessments. As of June 30, 2009, DIs held more than $1.3 trillion in liquid assets; an increase of 22% more than they held one year ago.

Under the NPR's proposed plan, FDIC-insured institutions that view the prepayment of over three years worth of assessments as too great a financial hardship can apply to the FDIC for an exemption from such prepayment. The FDIC stated that they would consider such exemptions on a case-by-case basis.

Comments to the FDIC on the NPR are due no later than October 28, 2009.

FINRA Requests Comments on Proposed Amendments to Rules Governing Communications With the Public

On September 21, 2009, the Financial Industry Regulatory Authority (FINRA) posted Regulatory Notice 09-55 requesting comments by November 20, 2009 on proposed new rules governing member communications with the public. The new rules would replace current NASD Rules 2210 and 2211, the Interpretive Materials that follow NASD Rule 2210, and portions of Incorporated NYSE Rule 472. Although the proposal is based on FINRA's existing rules, it would replace the existing six categories of communication with

three new communications categories and revises certain approval, filing and content requirements. Elements of the proposal are highlighted below.

Communications Categories

Currently NASD Rule 2210 divides communication into six separate categories: (i) advertisement, (ii) sales literature, (iii) correspondence, (iv) institutional sales material, (v) independently prepared reprint, and (vi) public appearance. FINRA is proposing to consolidate those six categories into the following three: (i) institutional communication, which would include communications that fall under the current definition of "institutional sales material," (ii) retail communication, which would include any written communication that is distributed or made available to more than 25 retail investors, and (iii) correspondence. Communications that currently qualify as advertisements and sales literature generally would fall in the proposed retail communication.

Approval Requirements

Principal Approval. The proposed rule changes would require an appropriately qualified registered principal of the firm to approve each retail communication before the earlier of its use or filing with FINRA. This proposal eliminates the requirement in NYSE Rule 472 that a "qualified person" approve in advance each advertisement, sales literature or other similar type of communication by an NYSE member firm. The proposed rule generally maintains the supervision and review standards for correspondence currently found in NASD Rules 2210 and 3010(d).

Filing Requirements

Filing Requirements for New Firms. FINRA rules currently require a firm that has previously not filed advertisements with FINRA or another self-regulatory organization to file its initial advertisement with FINRA at least 10 business days prior to use, and continue the practice for one year after the initial filing. The proposed rule alters the filing requirement in two respects. First, the requirement to file would cover all retail communications, rather than just advertisements. Second, the proposal triggers the one-year filing requirement beginning on the effective date a firm becomes registered with FINRA, rather than on the date an advertisement is first filed with FINRA.

Pre-Use Filing Requirement. The proposal would expand the current pre-use filing requirements so that communications concerning any registered investment company that includes self-created rankings, and retail communications that include bond mutual fund volatility ratings would have to be filed with FINRA at least 10 business days prior to first use and withheld from use until changes specified by FINRA staff have been made. The proposal would expand the filing requirements for materials relating to closed-end investment companies to include retail communications distributed after the fund's initial public offering.

Content Standards

The proposal largely incorporates the current content standards applicable to communication with the public that are found in the current rules. For example, content standards that currently apply to advertisements and sales literature generally would apply

to retail communications under the proposal. Some of the proposed modifications are as follows:

New Language on Application of Tax-Deferred vs. Taxable Illustrations. The proposal adds requirements based largely on existing FINRA guidance concerning comparative illustrations of tax-deferred versus taxable compounding, which would apply to any illustration, regardless of whether it appears in a communication promoting variable insurance products or some other communication, such as one discussing the benefits of investing in a 401(k) plan or individual retirement account. FINRA previously published this proposed rule language as part of a proposed rule change governing communications regarding variable insurance products in Regulatory Notice 08-39 (as discussed in the August 5, 2008 *Alert*).

Mutual Fund Performance Data. The current rule requires communications with the public, other than institutional sales material and correspondence, that present the performance of a non-money market mutual fund to disclose the fund's maximum sales charge and operating expense ratio as set forth in the fund's current prospectus fee table. The proposal alters this standard by requiring disclosure of the maximum sales charge and total operating expense ratio reflected in the fund's prospectus or annual report, whichever is more current as of the date the communication is submitted for publication.

Communications that Contain a Recommendation. The proposal revises the standards currently found in existing FINRA guidance for communications that contain a recommendation in part by extending those standards beyond just advertising and literature to retail communications, correspondence and public appearances. The proposal also extends the "fair and balanced" disclosure requirements to associated persons who recommend securities in public appearances. The current rule only applies to research analysts making public appearances.

ICI and IDC Issue Overview of Fund Governance Practices

The Investment Company Institute and the Independent Directors Council issued an updated overview of fund governance practices that looks at common fund governance practices during the period 1994-2008, based on data collected from participating fund complexes. The overview provides statistics in the following areas, along with brief explanatory discussions:

- Fund Total Net Assets and Total Independent Directors
- Fund Net Assets Served by Independent Directors
- Funds Served by Independent Directors
- Board Structure - Unitary or Cluster Boards
- Complexes with 75 Percent Independent Directors
- Number of Independent Directors for each Complex
- Frequency of Board Meetings
- Board Meetings and Committee Meetings in which Independent Directors Participated
- Independent Board Chair or Lead Director
- Independent Director Fund Share Ownership
- Independent Director Never Previously Employed by Fund Complex

- Mandatory Retirement Policy (including average age and the length of service for Independent Directors)
- Independent Counsel - Independent Director Use of Separate Counsel, Independent Director Reliance on Fund Counsel Different from Adviser's Counsel and Same Counsel for Fund and Adviser with No Independent Counsel
- Audit Committee Financial Expert

The overview highlights the following findings: (a) the number of complexes reporting that independent directors hold 75% or more of board seats has risen to 88%, (b) 63% of complexes reported having boards with independent chairs at year-end 2008, (c) independent directors at 96% of fund complexes were represented either by dedicated counsel or counsel separate from the adviser's at year-end 2008, with more than half having counsel separate from both fund counsel and the adviser's counsel, and (d) 97% of participating complexes reported that their boards' audit committees had an audit committee financial expert.

ICI and IDC Publish White Paper on Fund Relationships with Intermediaries

The Investment Company Institute and the Independent Directors Council have jointly published a white paper entitled "Navigating Intermediary Relationships" (the "Paper"), which examines the role of intermediaries in distributing mutual funds to investors. Intended to provide fund directors with background information about intermediaries, the Paper offers a summary of the intermediary role and the common types of intermediaries, such as broker-dealers, banks, fund platforms, insurance companies, investment advisers and retirement plan record keepers, and the types of financial and non-financial transactions between mutual funds and intermediaries. The Paper also provides a broad overview of the types of account structures used in intermediary relationships, including individual networked accounts and omnibus accounts. The Paper describes the different types of services provided by intermediaries, and briefly examines oversight of these services and the range of compliance functions intermediaries perform. The Paper offers a summary of the compensation arrangements for intermediaries, including 12b-1 fees, alternative shareholder servicing arrangements, finder's fees and revenue sharing.

The Paper concludes with appendices that provide additional detail regarding topics covered in the Paper, including types of intermediaries, processing and account structures, the history of Fund/SERV and Networking, relevant regulatory and compliance initiatives, sales charges and fee calculation methods and processing. One appendix is devoted to questions a board can ask to elicit information that will assist it in overseeing a fund's intermediary relationships.

Update on Report Addressing Harmonization of SEC and CFTC Regulation

On September 30, 2009, the chairmen of the SEC and CFTC announced that the two agencies expect to issue a report on October 15, 2009 that will address key difference between their regulatory schemes and recommend legislative and regulatory actions to address those differences where appropriate. The announcement identified the following areas to be covered in the report:

- Product listing and approval
- Exchange/clearinghouse rule approval under rules- versus principles-based approaches

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- Risk-based portfolio margining and bankruptcy/insolvency regimes
- Linked national market and common clearing versus separate markets and exchange-directed clearing
- Market manipulation and insider trading rules
- Customer protection standards applicable to broker-dealers, investment advisers and commodity trading advisers
- Cross-border regulatory matters

The report is also expected to include recommendations to Congress and the President designed to (1) strengthen the agencies' respective enforcement powers; (2) enhance and harmonize customer protection standards; and (3) establish an ongoing coordination and advisory process. The SEC and CFTC are preparing the report in response to a recommendation in the Treasury's June 2009 white paper on financial regulatory reform (as discussed in the June 23, 2009 *Alert*.)

OTHER ITEMS OF NOTE

Chairman of House Financial Services Committee Releases Discussion Draft of Proposed Derivatives Regulation Legislation

Congressman Barney Frank, Chairman of the House Financial Services Committee (the "Committee"), introduced a new legislative proposal, the "Over-the-Counter Derivatives Markets Act of 2009" (the "Proposed Act"), on October 2, 2009. The Committee will discuss the derivatives market reforms proposed by Chairman Frank at a hearing on Wednesday, October 7, 2009. The Proposed Act is a revision of the Treasury's proposed legislation regarding derivatives regulation which was submitted to Congress on August 11, 2009 (as discussed in the August 27, 2009 Goodwin Procter Client Alert). Chairman Frank's proposal follows on the heels of the "Comprehensive Derivatives Regulation Act of 2009," submitted by Jack Reed, Chairman of Senate Banking Subcommittee on Securities, Insurance and Investment, to the Senate on September 22, 2009 (for further information regarding Senator Reed's proposed legislation, please see the September 29, 2009 *Alert*).

EU Alternative Investment Fund Managers Directive has Implication for Non-EU Managers and Funds

The EU's Alternative Investment Fund Managers Directive, which is making its way through the EU legislative process, will in its current form significantly affect non-EU funds and managers that want to market to investors in the EU. For commentary and analysis on this development from our colleagues at SJ Berwin LLP, click here.