

FINANCIAL SERVICES ALERT

Goodwin Procter LLP has one of the largest financial services practices in the United States.

SUBSCRIBE

CONTACT US

FSA BACK ISSUES

CONSUMER FINANCIAL SERVICES ALERT

OTHER PUBLICATIONS

EDITORS

Eric R. Fischer

Jackson B.R. Galloway

Elizabeth Shea Fries

Disclaimer:

This publication, which may be considered advertising under the ethical rules of certain jurisdictions, is provided with the understanding that it does not constitute the rendering of legal advice or other professional advice by Goodwin Procter LLP or its attorneys.

IRS Circular 230 Notice:

To ensure compliance with requirements under Treasury Department Circular 230, we inform you that the contents of this *Alert* are not intended or written to be used, and may not be used, for the purpose of (i) avoiding U.S. federal tax penalties or (ii) promoting, marketing or recommending to another party any matter addressed herein. Each taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax adviser.

©2009 Goodwin Procter LLP
All rights reserved.

In this Issue:

Developments of Note

- House of Representatives Passes the Wall Street Reform and Consumer Protection Act of 2009
- House Adopts New OTC Derivatives Regulatory Regime
- Treasury Extends TARP Program to October 3, 2010 and Announces TARP Exit Strategy
- SEC Chairman and Director of Investment Management Speak about SEC Regulatory Initiatives
- FDIC Posts Transcript of Regulators' Audio Conference Concerning Interagency Policy Statement on Prudent CRE Loan Workouts

Other Items of Note

- SEC to Consider Adopting Compensation/Corporate Governance Disclosure and Adviser Custody Proposals at Open Meeting
- SEC Reopens Comment Period on Proposed Rules Relating to Shareholder Nominations

DEVELOPMENTS OF NOTE

House of Representatives Passes the Wall Street Reform and Consumer Protection Act of 2009

The U.S. House of Representatives (the "House") passed the Wall Street Reform and Consumer Protection Act of 2009 (the "Act") by a vote of 223-202. The Act combines all of the financial markets regulatory reform efforts previously approved by various House committees. For more on the bills that were included in the Act, please see the [December 8, 2009 Alert](#). If enacted, the Act would be the greatest change in the regulation of financial markets and products since the Great Depression. Among other things, the Act provides for (a) the creation of a regulatory and resolution regime for systemically significant financial companies, (b) a new Consumer Financial Protection Agency (the "CFPA"), (c) broadened adviser registration requirements and related measures designed to facilitate SEC oversight of unregistered funds (such as hedge funds) and (d) the regulation of the over-the-counter derivatives market (see the next article in this issue). The Act also contains restrictions on mortgage lending practices, limitations on executive pay, and additional investor protection requirements. It would reform the regulation of credit rating agencies and permit the Government Accountability Office (the "GAO") to audit the FRB. Though over 240 amendments to the Act were proposed, only 36 were considered by the House.

Manager's Amendment. Key among the amendments to the Act was a 249 page manager's amendment offered by House Financial Services Committee Chairman Barney Frank (the "Manager's Amendment") that, among other things, (i) preserves some federal preemption by permitting the OCC to overrule state consumer financial laws if they prevent,

significantly interfere with or materially impair national bank business and (ii) authorize \$4 billion of TARP funds for housing relief. The Manager's Amendment also (a) stipulates that CFPB regulations do not supersede state or federal consumer protection standards, (b) clarifies that the Financial Services Oversight Council is the chief regulatory body for systemic risk regulation, and (c) increases the ability of the FRB to prevent mergers, acquisitions and consolidations of non-bank financial holding companies. Another provision of the Manager's Amendment prevents the systemic risk regulator from overriding state or federal consumer protection standards, creating the potential for conflict between systemic risk and consumer protection concerns. The Act, as amended by the Manager's Amendment, provides that private student lenders must achieve institutional certification prior to offering loans to college students and that the CFPB and Department of Education must study the fairness of the terms of such loans. Bank branches would be required to display prominently overdraft fee rates and terms within 180 days of the Act's enactment.

Preemption. The preemption language in the Manager's Amendment, incorporated from an amendment offered by Rep. Melissa Bean of Illinois, is an important step back from the Obama Administration's original proposal to eliminate preemption entirely. Under the Manager's Amendment, the OCC may preempt state standards by writing a letter or issuing a ruling and may preempt similar standards of more than one state in one such ruling. The Manager's Amendment also reaffirms the deference given to the OCC's rulings by the courts and reduces the threshold required for the OCC to preempt state standards by stating that the OCC may override any law that "prevents, significantly interferes with or materially impairs" the business of banking. Additionally, the Manager's Amendment provides that banks may go directly to the courts to preempt a state standard without the OCC taking any action. However, operating subsidiaries of national banks do not receive the same preemption protections afforded national banks. The agreement on preemption also includes an explicit protection of the ability of national banks to export interest rates.

Changes to the CFPB. In addition to the changes regarding preemption standards, the Manager's Amendment contained further changes to the structure and jurisdiction of the CFPB. As expected, the Manager's Amendment provides that the CFPB is initially headed by a single director for a temporary period and then by a five-member commission established to govern the agency. The Manager's Amendment further provides for an office within the CFPB charged with ensuring that the policies and regulations of the CFPB do not create excessive burdens for community banks. Under the Manager's Amendment, the CFPB would be required to conduct rulemaking in areas where a majority of states have passed resolutions in support of the establishment or modification of consumer financial protection regulations. Additionally, under a separate amendment approved by the House the CFPB could regulate reverse mortgages.

Haircut for Secured Creditors. The Manager's Amendment reduces to 10% the haircut for the secured creditors of a systemically significant financial company in the event of a resolution of the company by the FDIC under the Act. The haircut for secured creditors was originally proposed at 20%. Significantly, the Manager's Amendment narrows the focus of the haircut to short-term lending of 30 days or less and carves out federally-backed credit including Federal Home Loan Bank advances, Treasury securities and debt guaranteed by the government-sponsored entities.

FDIC Emergency Debt Guarantee Program. The Manager's Amendment modifies the provisions of the Act that allow the FDIC to set up a debt guarantee program in the event of

a financial crisis. It establishes a \$500 billion cap for such a program and clarifies that any special assessment needed to cover losses under such program may only be assessed on participating financial institutions. The Manager's Amendment further provides that the FDIC may require collateral or warrants for assistance under such a program and that the FDIC may force a defaulting borrower under such a program into receivership or bankruptcy.

Deposit Cap for Mergers. Another key provision of the Manager's Amendment requires regulators to consider thrift deposits when calculating whether a merger violates the federal prohibition on mergers resulting in any one institution controlling more than 10% of U.S. deposits.

Private Fund Investment Adviser Registration. The Act includes provisions that effectively eliminate existing exemptions from investment adviser registration and broaden the regulatory framework for registered advisers, primarily by increasing the ability of the SEC and other regulators to oversee the activities of certain kinds of unregistered funds managed by registered advisers. These provisions are substantially similar to those of an earlier House bill discussed in the [October 15, 2009 Goodwin Procter Client Alert](#) and the [November 20, 2009 Goodwin Procter Client Alert](#) (which also discusses corresponding Senate legislation in this area).

Interest on Business Checking Accounts. Another amendment to the Act approved by the House repeals the prohibition on the payment of interest on demand deposits, including business checking accounts, one year after the Act's enactment.

Other Amendments. Other amendments of the Act approved by the House included an amendment clarifying that the financial services industry has sole responsibility for funding the systemic risk resolution fund "without recourse to the American taxpayer" and an amendment allowing an assessment to be levied on financial companies with \$50 billion or greater in assets to repay any shortfall on investments made under the TARP. Another amendment requires the FRB to issue a rule defining the term "significantly undercapitalized" to be used for monitoring financial companies and the financial system as a whole. The House also approved an amendment that requires the GAO to finish within two years the audit required under the Act of the FRB's actions during the current financial crisis.

Failed Amendments. Among those amendments that failed to pass was an amendment that would allow bankruptcy judges to modify the terms of mortgages on primary residences and an amendment replacing the CFPA with a 12 member council of regulators.

The *Alert* will continue its coverage of these and other issues concerning financial regulatory reform in future issues.

House Adopts New OTC Derivatives Regulatory Regime

The Wall Street Reform and Consumer Protection Act of 2009 (the "Act"), passed by the U.S. House of Representatives (the "House"), includes the latest legislative effort to regulate the over-the-counter derivatives market. Title III of the Act (the "Derivatives Act") is primarily based on the Derivatives Markets Transparency and Accountability Act, introduced by Rep. Collin Peterson and approved by the House Agriculture Committee on October 21, 2009 (the "Agriculture Committee Bill") with certain provisions imported from

the Over-the-Counter Derivatives Markets Act of 2009, introduced by Rep. Barney Frank and approved by the House Financial Services Committee on October 15, 2009 (the “Financial Services Committee Bill,” and together with the Financial Services Committee Bill, the “Earlier House Bills”). For discussion of the Earlier House Bills and their predecessors see the [November 2, 2009 Goodwin Procter Client Alert](#).

The Derivatives Act includes some significant changes from the Earlier House Bills and the Treasury’s proposed over-the-counter (“OTC”) derivatives legislation issued in August 2009 (the “Treasury’s Proposal”) (discussed in the [August 27, 2009 Goodwin Procter Client Alert](#)):

- *Beneficial Ownership Limits.* The Derivatives Act would limit a swap dealer’s and major swap participant’s beneficial ownership of interests in any clearing agency or swap execution facility to 20 percent. This limit would be imposed as part of a set of rules designed to minimize conflicts of interest in the decision making process that is broader than that proposed in either Earlier House Bill.
- *Parallel Regimes for Swaps and Security-Based Swaps.* Like the Earlier House Bills, the Derivatives Act would grant the SEC oversight authority over “security-based swaps” and grant the CFTC oversight authority over all other instruments defined as “swaps.” It would authorize each of the CFTC and SEC to *independently* issue rules subject to mandatory interagency consultation. Like the Agriculture Committee Bill, it would also adopt a dispute resolution mechanism that would allow each agency to petition the Court of Appeals for the District of Columbia Circuit for review of any rule or regulation which the agency deems conflicting with the proposed legislation.

Key Difference: While foreign exchange swaps and foreign exchange forwards are excepted from the Derivatives Act definition of “swap,” the CFTC would have authority to regulate these instruments as “swaps” (unlike under the Earlier House Bills).

- *Clearing and Exchange Trading Requirements.* Under the Derivatives Act, like the Earlier House Bills, if a registered clearing agency accepts a swap or security-based swap for clearing, such swaps or security-based swaps would be subject to a clearing requirement. Such swaps would have to be cleared through a registered clearing agency, and, if cleared, would also be required to be traded on a regulated exchange or electronic trading facility. A swap that is not accepted for clearing would be required to be reported to a swap repository or to the CFTC or SEC, as applicable.

Key Difference: The Derivatives Act moves away from Treasury’s proposed requirement that all “standardized” swaps be subject to mandatory clearing.

- *Capital and Margin Requirements; Position Limits.* Like Treasury’s Proposal and the Earlier House Bills, the Derivatives Act would require bank regulators to impose capital and margin requirements on bank participants in the derivatives markets. As under the Agriculture Committee Bill, the minimum capital and minimum initial and variation margin requirements applicable to all dealers and major market participants would be established, under the Derivatives Act, to “ensure the safety and soundness of the swap dealer or major swap participant” and as “are appropriate for the risk associated with the non-cleared swaps held as a swap dealer or major swap participant” (and the CFTC

and SEC would establish these requirements in consultation with bank regulators and each other, but otherwise independently).

Key Similarity: As under the Agriculture Committee Bill (but unlike the Financial Services Committee Bill or Treasury's Proposal), the Derivatives Act would expand the authority of the CFTC to set position limits for all physically deliverable commodities other than excluded commodities (which category would be defined by the CFTC).

- *Segregation; Set Aside.* The Derivatives Act would require the segregation of certain assets in connection with swap and security-based swap transactions. Specifically, with respect to any uncleared swaps or security-based swaps, at the request of the counterparty, a swap dealer would be required to segregate funds or other property and maintain such funds with a third-party custodian. If a swap counterparty is a swap dealer or major swap participant that owns more than 20 percent of a custodian, such custodian would not be considered independent for purposes of the segregation of certain assets. If the dealer does not segregate funds at the request of the counterparty, the dealer would be obligated to deliver quarterly reports to the counterparty, certifying that margin and collateral requirements are in compliance with the agreement between the parties.

Key Difference: The Derivatives Act does not include the mandatory set asides rules applicable to registered swap dealers included in the Agriculture Committee Bill.

- *Dealers.* The Derivatives Act would adopt the Agriculture Committee Bill's definition of "swap dealer," *i.e.*, any person who, as a significant part of its business, (i) holds itself out as a dealer, (ii) "makes a market in swaps," (iii) regularly engages in the purchase of swaps, or (iv) engages in any activity that would cause such person to be known as a dealer.

Key Difference: The Derivatives Act would provide for a *de minimis* exception for any entity that engages in a "de minimis amount of swap dealing[s] in connection with transactions with or on the behalf of its customers."

- *Major Market Participants.* Despite a late amendment approving narrower definitions of "major swap participant" and "major security-based swap participant," the definitions of major market participant under the Derivatives Act could still include certain investment funds and other "buy-side" market participants. The Derivatives Act adopts the Agriculture Committee Bill's definition which includes any person who maintains a substantial net position in outstanding swaps, excluding positions held primarily for hedging (or "whose outstanding swaps create substantial net counterparty exposure that could have serious adverse effects on the financial stability of the United States banking system or financial markets").

Key Ambiguity: In defining "substantial net position," the SEC would consider "a person's relative position in uncleared as opposed to cleared swaps."

- *Registration, Capital and Reporting Requirements.* Under the Derivatives Act as under previous legislative efforts, dealers and major market participants would have to

register, subjecting them to minimum capital and margin requirements, as well as a host of new business conduct and reporting and disclosure rules.

- *Mandatory Reporting for Transactions.* The Derivatives Act generally follows Treasury's Proposal with respect to reporting, a reflection of its origins in the Earlier House Bills. Clearing agencies, exchanges and swap execution facilities must report transaction information to the CFTC or SEC, as applicable (in the case of clearing agencies, to be shared with the CFTC/SEC, the Financial Services Oversight Council, other governmental agencies and federal financial supervisors). Swap repositories would be subject to similar reporting requirements.
- *Prohibition against Governmental Assistance.* Like the Earlier House Bills, the Derivatives Act would not be construed to authorize federal assistance to support the clearing operations or liquidation of a derivatives clearing organization or clearing agency.

Treasury Extends TARP Program to October 3, 2010 and Announces TARP Exit Strategy

Treasury Secretary Timothy Geithner has submitted to Congress a [letter](#), pursuant to Section 120(b) of the Emergency Economic Stabilization Act of 2009, announcing that the Troubled Asset Relief Program ("TARP") will be extended until October 3, 2010. Notwithstanding the extension, Secretary Geithner stated that the Treasury does not expect to deploy more than \$550 billion of the \$700 billion of funds allocated to the TARP and expects up to \$175 billion in TARP repayments by the end of 2010, and substantial additional repayments thereafter.

Secretary Geithner's letter also set forth an exit strategy for the TARP. The strategy is composed of four broad elements: (i) terminating and winding down the programs that have supported large financial institutions; (ii) limiting new TARP investments to housing, small business, and securitization markets that facilitate consumer and small business loans; (iii) maintaining the capacity to respond to potential financial threats; and (iv) continuing to manage equity investments acquired through the TARP in a commercial manner, while protecting taxpayers and unwinding those investments as soon as practicable. With respect to the second element, limited new TARP investments, Secretary Geithner outlined three TARP initiatives for 2010: (i) continued efforts to mitigate mortgage foreclosures in order to stabilize the U.S. housing market; (ii) the recently launched initiatives to provide capital to community banks to stimulate small business lending, as to which further details are expected to be released soon, and a reservation of funds for additional efforts to facilitate small business lending; and (iii) the possibility of an increased commitment to the Term Asset-Backed Securities Loan Facility that would not result in additional cost to taxpayers.

SEC Chairman and Director of Investment Management Speak about SEC Regulatory Initiatives

SEC Chairman Mary L. Schapiro and Andrew J. Donohue, Director of the SEC's Division of Investment Management, discussed SEC initiatives that would affect the investment management industry in speeches ([Schapiro speech](#), [Donohue speech](#)) earlier this month at a Consumer Federation of America 21st Annual Financial Services Conference and the ICI 2009 Securities Law Developments Conference, respectively.

- *Uniform Conduct Standard for Broker-Dealers and Advisers.* Ms. Schapiro expressed her view that all securities professionals should be subject to the same fiduciary duty. She commented that because investors do not differentiate between broker-dealers and investment advisers, SEC rules should not either, and all securities professionals “should be subject to the same standard of conduct, the same licensing and qualification requirements, the same disclosure obligations, the same regulatory and recordkeeping standards and a robust examination and oversight schedule.” Financial regulatory reform legislation, including the Wall Street Reform and Consumer Protection Act of 2009 recently passed by the U.S. House of Representatives (as discussed in the first story of this issue), has featured provisions giving the SEC the power to adopt rules that would require broker-dealers and advisers to observe a uniform standard of conduct when providing investment advice to retail customers.
- *Point of Sale Disclosure.* Ms. Schapiro also advocated point of sale disclosure requirements involving (a) information about the securities products and services being offered, (b) how the securities professional making the sale is compensated and (c) any conflicts of interest for the selling securities professional. The SEC already has outstanding a rule proposal regarding point of sale disclosure, which was most recently reissued for comment in March 2005. Point of sale disclosure requirements (to be defined by SEC rulemaking) have also been part of the various legislative proposals for financial regulatory reform. In addition, Senator Akaka’s Mutual Fund Transparency Act of 2009 (S.1964) includes point of sale disclosure requirements, in addition to broker-dealer fiduciary duty and broker-dealer compensation disclosure elements.
- *12b-1 Fees.* Ms. Schapiro indicated that she has asked the SEC staff for a recommendation to be considered in 2010 regarding 12b-1 fees, where she sees “a need for more fundamental change than merely disclosure reforms and a name change.” She believes the SEC “must critically rethink how 12b-1 fees are being used and whether they continue to be appropriate.” Mr. Donohue’s speech confirmed that his Division will be making a recommendation to the Commission in this area in 2010.
- *Retirement Products.* Ms. Schapiro indicated that she had requested that the SEC staff present its recommendations on target funds early in 2010. She noted the SEC’s ongoing cooperation with the Department of Labor in examining issues related to target date funds. Both she and Mr. Donohue indicated that the SEC staff had been focusing on marketing materials related to target date funds and the use of target dates in fund names. Mr. Donohue indicated that the SEC’s staff is also evaluating different approaches to investor education and prospectus disclosures for target date funds.
- *Derivatives.* Mr. Donohue noted that in response to his request an ABA Taskforce on Investment Company Use of Derivatives and Leverage was expected to issue a report on the use of derivatives by investment companies and the requirements regarding senior securities under Section 18 of the Investment Company Act of 1940, with recommendations on how the SEC can improve its regulations and regulatory guidance in this area.
- *Existing Rulemaking Proposals.* Mr. Donohue indicated that he hoped to make progress on two initiatives from March 2008, (1) a rule proposal to codify and expand the exemptive relief required for ETFs and facilitate additional investment by registered funds in ETFs (as discussed in the [April 1, 2008 Alert](#)) and (2) amendments to Form ADV Part 2 (as discussed in the [April 22, 2008 Alert](#)).

FDIC Posts Transcript of Regulators' Audio Conference Concerning Interagency Policy Statement on Prudent CRE Loan Workouts

The FDIC made publicly available a [transcript](#) of the December 3, 2009 interagency audio conference (the "Audio Conference") of the federal financial institutions bank regulatory agencies' (the "Agencies") [Joint Policy Statement on Prudent Real Estate Loan Workouts](#) (the "Policy Statement") issued October 30, 2009. The Policy Statement discusses banks' efforts to renew and restructure "loans to creditworthy borrowers who are experiencing diminished operating cash flows, depreciated collateral values or prolonged delays in selling or renting commercial properties." The Policy Statement also sets forth the components of an effective loan workout program and provides examples of the appropriate classification, non-accrued and troubled debt restructuring treatment of restructured loans.

The senior regulators who were panelists at the Audio Conference first discussed generally the Agencies' purposes in issuing the Policy Statement, appropriate bank risk management practices, general expectations of the Agencies for the manner in which a bank addresses its loan workout arrangements, and classifications of loans.

Subsequently, the Agency panelists at the Audio Conference responded to questions regarding the Policy Statement. Some of the important topics covered were:

- Appropriate treatment of loans that are bifurcated into two notes—a Note A (as to which the borrower has the ability to cover the debt service) and a Note B (as to which the borrower is unable to cover the debt service)
- At what point the Note A obligation may be returned to an accrual status
- Appropriate means of analyzing a borrower's global cash flow for purposes of projecting a cash flow surplus or deficit
- Evaluations and treatment of guarantees
- How lenders should determine and document a market rate of interest when reviewing an extension of credit
- Appropriate monitoring of restructured loans
- When substandard loans need not be placed on non-accrual status
- When a bank can appropriately use interest-only terms in a restructuring
- Monitoring collateral values and when new appraisals are required

OTHER ITEMS OF NOTE

SEC to Consider Adopting Compensation/Corporate Governance Disclosure and Adviser Custody Proposals at Open Meeting

At its open meeting on Wednesday, December 16, 2009, which will be webcast, the SEC will consider whether to adopt (1) amendments to rules and forms under the Securities Act of 1933, the Securities Exchange Act of 1934 and the Investment Company Act of 1940 to

PARTNERS AND COUNSEL

[Marco E. Adelfio](#)
[Lynne B. Barr](#)
[Gary A. Beller](#)
[Raymond P. Boulanger](#)
[John J. Cleary](#)
[Daniel T. Condon](#)
[Margaret B. Crockett](#)
[James S. Dittmar](#)
[Anna E. Dodson](#)
[Eric R. Fischer](#)
[James O. Fleckner](#)
[Elizabeth Shea Fries](#)
[Lynda T. Galligan](#)
[Jackson B.R. Galloway](#)
[John Hunt](#)
[James J. Kelly](#)
[Robert G. Kester](#)
[Robert M. Kurucz](#)
[Thomas J. LaFond](#)
[Paul W. Lee](#)
[William P. Mayer](#)
[Philip H. Newman](#)
[Sean P. O'Malley](#)
[Christopher E. Palmer](#)
[Byron C. Pavano](#)
[Regina M. Pisa](#)
[Mark S. Raffman](#)
[Robert S. Seigal](#)
[Brenda R. Sharton](#)
[Kevin L. Sheridan, Jr.](#)
[Derek N. Steingarten](#)
[William E. Stern](#)
[Marian A. Tse](#)
[Kimberly K. Vargo](#)
[Scott A. Webster](#)
[Michael P. Whalen](#)

require additional disclosures from registrants about “compensation and other corporate governance matters” (for more on this proposal, see the [July 14, 2009 Alert](#)) and (2) amendments to the investment adviser custody rule (Rule 206(4)-2 under the Investment Advisers Act of 1940) and related forms and rules (for more on this proposal, see the [May 26, 2009 Alert](#)).

SEC Reopens Comment Period on Proposed Rules Relating to Shareholder Nominations

The SEC issued a [release](#) reopening the comment period on proposed amendments to its proxy rules designed to facilitate shareholder nomination of directors (as discussed in the [June 16, 2009 Alert](#)), in order to allow comment on data and analysis that has been added to the [public comment file](#) for the proposal, some of it at or following the August 17, 2009 close of the initial comment period. Comments must be received no later than 30 days after the release is published in the *Federal Register*.