

FINANCIAL SERVICES ALERT

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DEVELOPMENTS OF NOTE

SEC Reopens Comment Period on Model Privacy Notice

The SEC reopened the period for public comment on a model privacy notice (the "Model Notice") that financial institutions would be able to use to provide disclosures in accordance with the privacy notice provisions of the Gramm-Leach-Bliley Act (the "GLBA"). As reported in the [March 27, 2007 Alert](#), in accordance with the Financial Services Regulatory Relief Act of 2006 (the "Relief Act"), eight federal regulators, including the SEC, proposed the Model Notice to provide for the simplified privacy notice called for by the Relief Act. The comment period was reopened to allow public comment on the results of consumer testing of different types of privacy notices, including a slightly revised version of the Model Notice, conducted by an outside consultant, which had occurred subsequent to the initial comment period. The results of the consumer testing have been posted in the comment file for the Model Notice at <http://www.sec.gov/comments/s7-09-07/s70907-21.htm>.

Privacy Notices. Under rules adopted pursuant to the GLBA, a financial institution must provide notice to certain of its customers of its policies regarding the disclosure of those customers' nonpublic personal information to affiliated and non-affiliated third parties. These privacy notice provisions also require that the consumer be provided with, where applicable, a reasonable opportunity to "opt out" of certain sharing of nonpublic information. The privacy notice must be provided by the financial institution to the customer at the start of the relationship and annually during the existence of the relationship. Regulation S-P ("Reg. S-P") implements the privacy provisions of the GLBA for entities subject to SEC oversight. If the SEC adopts the Model Notice, a financial institution would not be required to use the Model Notice to meet Regulation S-P's privacy notice requirements. During the first year after adoption, both the Model Notice and the

sample clauses for privacy notices currently provided in Reg. S-P would serve as safe harbors under the GLBA; however, after the one-year transition period, the sample clauses would no longer have that status, leaving the Model Notice as the sole safe harbor.

The reopened comment period ends May 20, 2009.

IRS Issues Guidance on Application of Section 382 to Treasury's Acquisition of Instruments Issued by Recipients of TARP Funds

The Internal Revenue Service (the "IRS") on April 13, 2009 issued Notice 2009-38 (the "Notice") to provide guidance to corporations whose instruments are acquired by the Treasury Department under the Capital Purchase Program of the Emergency Economic Stabilization Act ("EESA") and the Troubled Asset Relief Program ("TARP"). The Notice clarifies the interplay of many of the bailout programs with Section 382 of the Internal Revenue Code of 1986 (the "Code"), which addresses losses following an ownership change.

Notice 2009-38 applies to corporate issuers following the Treasury's acquisition of instruments under the Capital Purchase Program for a broad range of entities, including publicly traded issuers, private issuers, and Subchapter S corporations. It also provides guidance for an expanded list of EESA acquisition programs, including the Targeted Investment Program, the Asset Guarantee Program, the Systemically Significant Failing Institutions Program, the Automotive Industry Financing Program, and the Capital Assistance Program for publicly traded issuers ("TARP CAP").

Notice 2009-38 states that any instrument (other than warrants) issued to the Treasury pursuant to any of the programs, except for TARP CAP, whether owned by the Treasury or subsequent holders, "shall be treated for all federal income tax purposes as an instrument of indebtedness if denominated as such, and as stock described in Section 1504(a)(4) of the Code if denominated as preferred stock." Importantly, no instrument so denominated shall be treated as stock for purposes of Section 382 of the Code while held by the Treasury or by other holders, except that preferred stock described in Section 1504(a)(4) will be treated as stock for purposes of Section 382(e)(1). However, for any instrument issued to the Treasury under TARP CAP, the appropriate classification shall be determined by applying general principles of Federal tax law.

The Notice further indicates that the IRS will treat warrants to buy stock issued to the Treasury (with the exception of two of the programs) as options and not as stock, and not "be deemed exercised" under Treasury Regulation Section 1.382-4(d)(2). The two exceptions are the Capital Purchase Program for private issuers and the Capital Purchase Program for S corporations. For both programs, the IRS will treat any such warrant as an ownership interest in the underlying instrument: warrants for stock in the private-issuer Capital Purchase Program will be treated as an ownership interest in the underlying stock, and thus treated as preferred stock under Section 1504(a)(4); and warrants issued in the S corporation program will be treated as an ownership interest in the underlying indebtedness.

Significantly, the Notice indicates that no matter what the Treasury's ownership of the stock is on any given date, it will not be considered to have caused the Treasury's ownership in the issuing corporation to have increased over its lowest percentage owned on any earlier date. In general, Section 382 of the Code limits a corporation's deduction for net operating loss carryovers and recognized built-in losses subsequent to an ownership change. An

ownership change, as defined in Section 382(g) of the Code, is generally a change of 50% or more of the ownership of a corporation within a three-year period. Prior to this Notice and similar earlier guidance, the Treasury Department's acquisition of certain stock of a corporation could have resulted in an ownership change, thereby limiting the corporation's ability to utilize prior losses to reduce its taxable income.

Notice 2009-38 addresses the measuring of shifts in ownership by any 5 percent shareholder on any testing date occurring on or after the date on which an issuing corporation redeems its stock from the Treasury. The IRS noted that the stock so redeemed shall be treated as if it had never been outstanding. However, the stock will be considered outstanding for purposes of determining the percentage of stock owned by other 5 percent shareholders on a testing date.

Any capital contribution made by the Treasury pursuant to the EESA acquisition programs shall not be considered to have been made as part of a plan a principal purpose of which was to avoid or increase any Section 382 limitation, by for instance, artificially increasing the value of the loss corporation. Also, any amount received by an issuer in exchange for instruments issued to the Treasury under the EESA acquisition programs is treated as received, in its entirety, as consideration for such instruments.

Corporations may choose to rely on the rules described in the Notice, as the guidance is optional for taxpayer use. Moreover, the rules will continue to apply "unless and until there is additional guidance." The federal tax consequences of instruments not described in the Notice will continue to be determined based upon the application of general principles of Federal tax law. Notice 2009-38 supersedes and amplifies Notice 2009-14, which provided similar guidance but was unable to address subsequently developed programs.

FRB Grants 23A Waiver for Transfer of MBS Paid for by Dutch Government

The FRB granted a waiver from Section 23A of the Federal Reserve Act to allow a thrift subsidiary of ING Groep, N.V. ("ING") to transfer an 80 percent participation interest in a pool of Alt-A residential mortgage-backed securities ("MBS") to a nonbank affiliate ("Affiliate"). In exchange for the asset transfer, Affiliate would assign to the thrift its rights to a stream of fixed payments from the Kingdom of the Netherlands.

The FRB stated that the transaction constituted a loan for purposes of Section 23A, and thus a covered transaction, because the thrift would transfer assets to Affiliate for a stream of future payments. An exemption from Section 23A appeared appropriate in this circumstance, however, because in substance this was a transfer of risk from the thrift to the Netherlands. The FRB noted that the interposition of Affiliate creates some risk (*i.e.*, insolvency of Affiliate), however the parties had taken several steps to mitigate that risk, including the fact that Affiliate conducts minimal business, and that ING will guarantee the amounts due to the thrift under this arrangement. The thrift also asserted that the transaction would provide public benefits by facilitating the Netherlands' efforts to improve significantly the thrift's capital position.

Treasury Releases Capital Purchase Program Term Sheets for Mutual Banks and Savings Association

Following up on the Capital Purchase Program ("CPP") terms for mutual holding companies, the Treasury released CPP terms for mutual banks and savings associations.

For a discussion of the terms for mutual holding companies, please see the [April 14, 2009 Alert](#). Under this term sheet, mutual banks and savings associations that are not controlled by a bank holding company or savings and loan holding company may sell subordinated debentures (“Senior Securities”) to the Treasury. The aggregate principal amount of the Senior Securities must be between 1% and 3% of the risk-weighted assets of the issuing mutual bank or savings association but in no event may exceed \$25 billion. The Senior Securities are senior to mutual capital certificates and other capital instruments authorized by state law, but must be subordinated to claims of depositors and to the mutual institution’s other senior indebtedness, unless such senior indebtedness is expressly made *pari passu* or subordinated to the Senior Securities. Significantly, unlike the CPP instruments for other forms of banking organizations, the Senior Securities qualify as Tier 2 capital rather than Tier 1 capital. The Senior Securities have a maturity of 30 years and are freely transferable. The Senior Securities have no voting rights other than class voting rights on the issuance of equity securities or other capital instruments which purport to rank senior to the Senior Securities, any amendment to the rights of the Senior Securities and any merger or similar transaction.

The annual interest rate on the Senior Securities will be 7.7% for five years and after the fifth anniversary the annual interest rate will increase to 13.8%. If interest is not paid for six quarters, whether or not consecutive, holders of Senior Securities have the right to elect two directors. Mutual banks and savings associations participating in the CPP are subject to certain restrictions on the payment of dividends, including extraordinary dividends on deposit accounts, and the repurchase and redemption of equity securities, capital certificates, or other capital instruments. Many of these dividend and repurchase restrictions do not apply if the Treasury has transferred the Senior Securities to a third party. After ten years, participating mutual banks and savings associations may not pay any dividends or redeem or repurchase any equity securities, capital certificates, or other capital instrument until the Senior Securities are fully redeemed.

The Treasury also will receive warrants to purchase additional Senior Securities (“Warrant Securities”) in an amount equal to 5% of the Senior Securities purchased on the date of the investment, subject to certain reductions. The Treasury intends to immediately exercise the warrants. The Warrant Securities have the same rights and terms as the Senior Securities, except that the annual interest rate is always 13.8% and the Warrant Securities may not be redeemed until all of the Senior Securities have been redeemed.

The deadline for mutual banks and savings associations to apply to participate in the CPP is 5 p.m., Eastern Time, on May 14, 2009. Participating mutual banks and savings associations will be subject to the executive compensation, transparency, accountability and monitoring guidelines applicable to other TARP recipients. Senior Securities may be redeemed with the approval of the appropriate Federal banking agency at 100% of the issue price plus any accrued and unpaid interest.

OCC Publishes Interpretive Letter Regarding Issuance of Common Stock Below Par

The OCC issued an interpretation (OCC Interpretive Letter #1112, “Letter #1112”) confirming that a national bank (the “Bank”) may issue common stock at an issue price lower than par value and that the assessment provisions of the National Bank Act (the “NBA”) do not apply to stock so issued. Prior to Letter #1112, it was not clear from the language of the NBA or from the OCC’s regulations that national banks were permitted to issue stock with an issue price below par value; in fact, the OCC’s Licensing Manual

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provides that “Banks should consult with the OCC prior to considering a sale of common stock at a price below par value”.

Letter #1112 permits the Bank to issue stock below par value provided that the Bank maintains adequate capital. More specifically, adequate capital must be maintained by the transfer of funds from the Bank’s capital surplus account to its capital stock account in an amount sufficient to ensure that the capital stock account is funded as if all common stock has been issued at par value. For example, where a bank issues 1,000,000 shares of common stock at \$4.00 per share, and the par value of such common stock is \$5.00, the bank must transfer \$1,000,000 to its capital stock account. The bank must also maintain adequate capital under the OCC’s other capital regulations and comply with all applicable laws and regulations in connection with the issuance of common stock. Letter #1112 also confirms that to the extent that the Bank “trues-up” its capital stock account from its capital surplus account in the manner described above, the issuance of stock below par value would not be subject to assessment for impairment or deficiency pursuant to the NBA. The relevant transaction described in the OCC’s interpretive guidance is a private sale of stock; however, the OCC does not describe the non-public nature of the sale of stock as an important factor in its decision to permit the transaction.

Letter #1112 also makes the more general statement that matters related to the pricing of stock are “corporate governance procedure[s]” and therefore, the Bank is permitted to price its stock in accordance with the corporate governance procedures that the Bank has selected in its corporate documents, so long as such pricing is not inconsistent with the Bank’s safety and soundness.

OTHER ITEM OF NOTE

Goodwin Procter Launches Blog Covering Financial Crisis and Recovery

We are pleased to announce that Goodwin Procter has created a Blog that captures the wealth of our broad expertise on all aspects of the current financial crisis and the accompanying recovery efforts. Goodwin Procter is uniquely positioned to comment on and respond to issues in all industries affected by this crisis, including banking, hedge funds, investment management, capital markets and real estate.

Goodwin Procter provides regular updates and advisories that provide insight into the full range of business and legal issues brought on by rapidly shifting markets and sweeping regulatory changes in the financial services industry. The Blog is designed to serve as a topical digest of these publications to help you determine how these issues might affect your business and legal affairs and to help you navigate the myriad legislative, regulatory and enforcement challenges that may present themselves as a result of this crisis. For example, we recently compiled a document which summarizes the continuing creation of governmental programs in response to the financial crisis, “The ABC’s of TARP”. For this and other insights, please visit this new site at: <http://www.financialcrisisrecovery.com/>

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