

# FINANCIAL SERVICES ALERT

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## DEVELOPMENTS OF NOTE

### **U.S. Supreme Court Rules That States May Enforce Certain State Banking Laws Against National Banks Through Judicial Enforcement Actions**

The U.S. Supreme Court ruled that a state may enforce certain of its banking laws against national banks through judicial enforcement proceedings, but not through non-judicial requests for information. The New York Attorney General's Office had requested certain non-public information from national banks through letters "in lieu of subpoena" in connection with a fair lending investigation. The banks obtained an injunction from the district court prohibiting the AG from enforcing state fair lending laws either through subpoenas or judicial proceedings, on the grounds that federal law preempts such

enforcement, and the Second Circuit affirmed. The Court disagreed as to the AG's use of judicial proceedings, rejecting the OCC's argument that a state's "visitorial powers" included "prosecuting enforcement actions." The Court held that, under common law, visitorial powers encompassed a state's ability to engage in administrative oversight of corporations, but did not extend to judicial enforcement activities. As such, the Court overturned that portion of the injunction which prevented the AG from bringing a judicial action to enforce certain New York state laws against national banks. The Court also found, however, that the threat of non-judicial enforcement through the use of executive subpoenas did fall within the definition of "visitorial powers," and thus upheld that portion of the injunction. [Click here](#) for *Cuomo v. Clearing House Association, L.L.C.*, No. 08-453 (U.S. June 29, 2009)

## **SEC Proposes Rule Amendments Affecting Money Market Funds**

The SEC has proposed amendments to Rule 2a-7 under the Investment Company Act of 1940, as amended, the SEC rule that sets forth the principal requirements relating to money market funds. According to the SEC, the objective of the proposed amendments is to position money market funds to withstand severe market pressures, such as the pressures money market funds faced in the fourth quarter 2008. Specifically, the proposed amendments are designed to achieve that objective by tightening the risk-limiting provisions in Rule 2a-7.

Because the formal release proposing the amendments was not made available until this edition was being finalized for distribution, this summary is based on the SEC press release announcing the proposal and proceedings of the SEC open meeting at which the vote to propose the amendments was taken. A future edition of the *Alert* will discuss the proposing release.

Many of the proposed changes are based on the recommendations of the ICI's money market working group (discussed in the [April 28, 2009 Alert](#)). Some are based on recommendations included in the U.S. Treasury's recent white paper on financial markets regulatory reform (discussed in the [June 23, 2009 Alert](#)).

The proposed amendments would require a money market fund to, among other things:

- Maintain certain minimum percentages of its portfolio in cash or securities that can be readily converted to cash, to pay redeeming investors;
- Shorten the weighted average maturity limits applicable to its portfolio from 90 days or less to 60 days or less;
- Maintain a "weighted average life maturity" limit (that is, the weighted average maturity calculated without consideration of Rule 2a-7's maturity shortening provisions) of 120 days or less, which would limit a money market's investments in long-term floating rate securities;
- Limit "Eligible Securities" to only the highest quality securities, that is, eliminate the ability to acquire limited amounts of "Second Tier" securities as currently permitted under Rule 2a-7; a money market fund could hold a Second Tier security if, at the time it was acquired, the security was an Eligible Security;

- Periodically stress test the fund's portfolio to determine whether it can withstand significant market turbulence and still maintain a stable net asset value;
- Report its portfolio holdings monthly to the SEC and post them on the fund's public website within 2 business days following the end of the month; and
- Be able to process purchases and redemptions at a price other than \$1 per share, that is, be operationally capable of processing shareholder transactions in the event it "breaks the buck."

The proposed amendments also would:

- Permit a money market fund, if it has "broken the buck" and decided to liquidate, to suspend redemptions while the money market fund undertakes an orderly liquidation of assets;
- Make it easier for affiliates to acquire troubled assets from a money market fund;
- Prohibit a money market fund from acquiring illiquid securities, which currently are limited to 10% of a money market fund's assets in accordance with the SEC staff's views;
- Require a money market fund to disclose its "shadow" (that is, its market-based) net asset value per share calculations; and
- Require a money market fund to develop procedures to identify investors whose redemption activity may pose a risk to the fund.

The SEC is seeking comment on, among other things:

- Whether money market funds should continue to be able to maintain a stable net asset value per share using the amortized cost method, that is, whether money market funds should be required to value securities in the same manner as other open-end funds, generally at market value, or failing that, fair value;
- Whether money market funds should be required to have the capability to make in-kind redemptions. At the open meeting, the staff of the SEC's Division of Investment Management suggested that in-kind redemptions could be an alternative to floating share prices, and would essentially provide some "friction" to discourage institutional investors from making a "run" on the money market fund. There would be limits, however, on in-kind redemptions to retail investors;
- Whether to eliminate references in Rule 2a-7 and other SEC rules to nationally recognized statistical ratings organizations ("NRSROs") (the SEC previously made a similar proposal in 2008, as discussed in the [July 8, 2008 Alert](#));
- Whether to require a money market fund board to designate several NRSROs that the money market fund will track to determine whether a security is eligible for acquisition or continues to be an Eligible Security; and

- How asset backed securities should be treated under Rule 2a-7, that is, whether the current treatment of ABS under Rule 2a-7 adequately protects money market funds.

Comments on the proposed amendments are due by September 8, 2009.

## **IOSCO Publishes Final Report Recommending Principles for Hedge Fund Oversight**

The Technical Committee of the International Organization of Securities Commissions (“IOSCO”) published “Hedge Funds Oversight: Final Report” (the “Report”), which articulates six high level principles designed to enable securities regulators in different jurisdictions to address the regulatory and systemic risks posed by hedge funds using a globally consistent approach. The Report emphasizes the need for collective global action and application, but acknowledges that some of the Technical Committee’s recommendations will need support from other regulators, including banking standard setters. The Report also calls for a strengthening of regulatory resources and improved information sharing among regulators. SEC Commissioner Kathleen Casey chairs the Technical Committee.

The six high level principles are as follows:

- (1) Hedge funds and/or hedge fund managers/advisers should be subject to mandatory registration;
- (2) Hedge fund managers/advisers that are required to register should also be subject to appropriate ongoing regulatory requirements relating to:
  - Organizational and operational standards;
  - Conflicts of interest and other conduct of business rules;
  - Disclosure to investors; and
  - Prudential regulation.
- (3) Prime brokers and banks that provide funding to hedge funds should be subject to mandatory registration/regulation and supervision. They should have in place appropriate risk management systems and controls to monitor their counterparty credit risk exposures to hedge funds;
- (4) Hedge fund managers/advisers and prime brokers should provide to the relevant regulator information for systemic risk purposes (including the identification, analysis and mitigation of systemic risks);
- (5) Regulators should encourage and take account of the development, implementation and convergence of industry good practices, where appropriate;
- (6) Regulators should have the authority to co-operate and share information, where appropriate, with each other, in order to facilitate efficient and effective oversight of globally active managers/advisers and/or funds and to help identify systemic risks, market integrity and other risks arising from the activities or exposures of hedge funds with a view to mitigating such risks across borders.

The Report notes that the focus of the initiative that produced the Report was on hedge funds, and not on “other potentially ‘unregulated’ entities such as private equity funds,” or

special investment vehicles. It goes on to state, however, that many of the Report's observations and conclusions may be applicable to other market participants that hold or control large pools of capital. (The Technical Committee issued a final report on private equity in May 2008, which is available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD274.pdf>.)

The Report, which includes additional detail on disclosure (to investors and to regulators), risk management, operational standards and areas of oversight, is available at [www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf](http://www.iosco.org/library/pubdocs/pdf/IOSCOPD293.pdf)

## **FDIC Adopts Final Rule Amending Annual Audit and Reporting Rules under Part 363**

The FDIC adopted a final rule (the "Final Rule") that amends FDIC-insured financial institutions' ("FIs") annual audit and reporting requirements under section 36 ("Section 36") of the Federal Deposit Insurance Act and its implementing regulations, Part 363 ("Part 363"). In general, the Final Rule incorporates into Part 363 certain audit, reporting and audit committee practices derived from the Sarbanes-Oxley Act of 2002 as well as FDIC experience in administering Part 363. The FDIC stated that Section 36 and Part 363 are "generally intended to facilitate early identification of problems in financial management" at FIs with total assets greater than certain thresholds. The asset threshold for internal control assessments is \$1 billion, and the threshold for the other requirements of Part 363 is \$500 million. In October 2007, the FDIC issued a proposed version (the "Proposed Rule") of the Final Rule that was discussed in the [October 23, 2007 Alert](#).

In addition to making certain technical amendments to the enforcement rules and procedures used against accountants and accounting firms, the FDIC cites 13 significant changes made by the Final Rule to Part 363. The 13 key changes:

- (1) Require management of the FI and its independent public accountant to identify the internal control framework used to evaluate internal control over financial reporting and disclose all identified material weaknesses that have not been remediated;
- (2) Extend the time period for a non-public FI to file its Part 363 Annual Report by 30 days and replace the 30-day extensions of the filing deadline that may be granted if an FI (public or non-public) is confronted with extraordinary circumstances beyond its reasonable control with a late filing notification requirement that would have general applicability;
- (3) Provide relief from the annual reporting requirements for FIs that are merged out of existence before the filing deadline;
- (4) Provide relief from reporting on internal control over financial reporting for businesses acquired during the fiscal year;
- (5) Require management's assessment of compliance with designated safety and soundness laws and regulations to state management's conclusion regarding compliance and disclose (with more specificity than is currently required) any noncompliance with such laws and regulations (the safety and soundness laws currently covered are those concerning insider loans and dividend restrictions);
- (6) Clarify the independence standards with which independent public accountants must comply and enhance the enforceability of compliance with these standards;

- (7) Specify that the duties of the audit committee include the appointment, compensation and oversight of the independent public accountant and require audit committees to ensure that audit engagement letters do not contain unsafe and unsound limitation of liability provisions. The Proposed Rule's requirement that FIs must file copies of audit engagement letters does not appear in the Final Rule;
- (8) Require certain communications by independent public accountants to audit committees.
- (9) Establish retention requirements for audit working papers;
- (10) Require boards of directors to adopt written criteria for evaluating an audit committee member's independence and provide expanded guidance for boards of directors to use in determining independence. In a change from the Proposed Rule, the Final Rule states that a committee member is deemed independent if his total annual compensation from the institution (other than director and committee fees) is \$100,000 or less (raised from \$60,000 or less);
- (11) Provide that ownership of 10% or more of any class of voting securities of an institution is not an automatic bar for considering an outside director to be independent of management;
- (12) Require the total assets of a holding company's insured depository institution subsidiaries to comprise 75 percent or more of the holding company's consolidated total assets in order for an FI to comply with Part 363 at the holding company level; and
- (13) Provide illustrative management reports to assist FIs in complying with the annual reporting requirements.

Except for certain items specifically noted in the Final Rule, the Final Rule will become effective 30 days after its publication in the *Federal Register*

### **FinCEN Issues Guidance on Scope of Permissible Information Sharing under Section 314(b) of the PATRIOT Act**

The Financial Crimes Enforcement Network ("FinCEN") issued interpretive guidance (the "Guidance") concerning the application of Section 314(b) ("Section 314(b)") of the USA PATRIOT Act (the "PATRIOT Act"). Section 314(b) permits financial institutions ("FIs" and each an "FI") and associations of FIs to share information concerning individuals, entities, organizations and countries suspected of possible terrorist or money laundering activities. To take advantage of the information sharing safe harbor under Section 314(b), an FI must comply with all of the conditions to usage of the safe harbor, including: (1) providing notice to FinCEN; (2) taking reasonable steps to verify that the other sharing FI has submitted the required notice to FinCEN; (3) imposing restrictions on the usage of shared information; and (4) taking steps to ensure the security of information shared (the "Safe Harbor Conditions"). The Guidance states that, to the extent FIs share information related to possible money laundering activities (including those associated with use of proceeds derived from specified criminal activities) or related to possible terrorist activity, such information sharing is protected by the Section 314(b) safe harbor, provided that the Safe Harbor Conditions have been satisfied. The Guidance stresses, however, that when an FI shares information under the 314(b) safe harbor, it may not disclose the filing or existence of a Suspicious Activity Report ("SAR"), but may disclose the facts underlying the SAR.

## **Federal Banking Agencies Seek Comments on Proposed Rulemaking for the Community Reinvestment Act**

The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision, (collectively, “the Agencies”) in a notice of proposed rulemaking, jointly requested public comments on proposed revisions to regulations implementing the Community Reinvestment Act (the “CRA”).

In accordance with the recently enacted Higher Education Opportunity Act, the Agencies are proposing to implement regulations that would require the Agencies to consider, as a factor, when evaluating and rating an insured depository institution’s (“institution”) community reinvestment record, low-cost education loans provided by the institution to low-income borrowers in its assessment area who have an individual income of less than 50% of the area median income. The proposal defines “low-cost education loans” as (1) education loans originated by an institution through a U.S. Department of Education loan program or (2) any private education loan as defined in the Truth in Lending Act, including loans under a state or local education loan program, originated by an institution for a student at an institution of higher education, with interest rates and fees no greater than those of comparable education loans offered through loan programs of the U.S. Department of Education.

The Agencies also propose to incorporate into their rules the statutory language that allows the Agencies, when assessing and rating the community reinvestment record of an institution that is not minority- or women-owned, to consider, as a factor, capital investment, loan participation and other ventures undertaken by that institution in cooperation with minority- and women-owned institutions and low-income credit unions, provided that these activities help meet the credit needs of the local communities in which the minority- or women-owned institutions and low-income credit unions are chartered. The proposed language would clarify that if the activities of the nonminority- and nonwomen-owned institution benefit the communities in which the minority- or women-owned institutions or credit unions are chartered, then the activities need not also benefit the nonminority- and nonwomen-owned institution’s assessment area.

The Agencies seek comments on all aspects of the proposal, including: the definition of “education loans,” such as whether only loans for borrowers to attend post-secondary education or accredited institutions should be covered; the limitation of CRA consideration to education loans that the institution originated; the determination of which education loans are “low-cost” and which borrowers are “low-income”; the consideration of education loans as consumer loans; and whether it is readily apparent that the proposed provisions are applicable to all institutions.

Public comments on the proposed revisions must be received by July 30, 2009. The joint notice is available at <http://www.fdic.gov/news/news/press/2009/pr09098a.pdf>.

## **FINRA Proposes Amendments to Cash Compensation Requirements of Rules Governing Sales of Investment Company Securities**

As part of the consolidation of the NASD Rules and incorporated New York Stock Exchange rules into the Consolidated FINRA Rulebook, FINRA issued a Regulatory Notice

that proposes to adopt FINRA Rule 2341 (the “Proposed Rule”) regarding the regulation of members’ activities in connection with the sale and distribution of securities (“Securities”) issued by a registered investment company (a “fund”). The Proposed Rule is based largely on current NASD Rule 2830 (the “Current Rule”). It would also (a) codify existing FINRA staff interpretative guidance permitting the trading of Exchange Traded Fund (“ETF”) shares at prices other than the current net asset value of the ETF consistent with applicable SEC rules or exemptive orders; and (b) modify section (c) of the Current Rule to eliminate the requirement that sales of Securities to a retail broker-dealer by the fund’s underwriter at a price other than the fund’s public offering price comply with NASD Rule 2420 (Dealing with Non-Members). Additionally, the Proposed Rule would modify member recordkeeping requirements with respect to non-cash compensation arrangements by requiring that the value of all noncash compensation arrangements, which may be based on a good faith estimate in instances where evidence of the actual value is not available, be maintained in the members’ records.

*Proposed Changes to Cash Compensation Disclosure Requirements.* The Proposed Rule would modify the cash compensation disclosure requirements of the Current Rule. Specifically, the Proposed Rule would revise the current member disclosure requirements with respect to cash compensation received from an offeror of Securities to (1) require that standard “sales charges and service fees” (rather than all cash compensation) be described in a fund’s prospectus, (2) eliminate the term “special cash compensation” and instead requiring prospectus disclosure where a member receives a greater (or special) sales charge or service fee than is ordinarily paid in connection with sales of Securities, and (3) require a member that receives cash payments in addition to the standard sales charges and service fees paid in connection with the sale of Securities (“Special Payments”) (such as sales commissions or service fees, or revenue sharing payments made by offerors to members) to disclose (a) that information about a fund’s fees and expenses may be found in the fund’s prospectus, (b) if applicable, that the firm receives Special Cash Payments, the nature of such Special Cash Payments received in the last 12 months and a list of offerors making such Special Cash Payments listed in descending order of payments received; and (c) provide a reference to an internet page or toll-free number at which updated information regarding Special Cash Payments, which must be updated at least every six months, is available.

The Proposed Rule would also provide supplemental material clarifying that (1) cash compensation includes revenue sharing paid in connection with the sale and distribution of Securities (and therefore members would be required to disclose revenue sharing arrangements pursuant to the rule); and (2) a special sales charge or service fee arrangement includes any arrangement under which a member receives greater sales charges or service fees than other member firms selling the same Securities, even if an offeror would have made the same arrangement available to other members had they requested it.

The comment period on the proposal expires August 3, 2009.

### **FDIC Issues Notice of Proposed Rulemaking Concerning Potential Extension of the Transaction Account Guarantee Program**

The FDIC issued a notice of proposed rulemaking (the “NPR”) seeking comment on two alternatives for the conclusion of the Transaction Account Guarantee Program (“TAGP”), a component of the FDIC’s Temporary Liquidity Guarantee Program. The TAGP provides

an unlimited FDIC guarantee for deposits in noninterest-bearing transaction accounts at banks and thrifts that participate in the TAGP.

The first proposed alternative would not change the FDIC's current regulation. Under this alternative, the FDIC's guarantee for deposits held in qualifying noninterest-bearing transaction accounts would expire on December 31, 2009. There would be no increase in fees for this coverage.

The second proposed alternative would extend the TAGP for six months, until June 30, 2010, and annual fees would be increased from 10 basis points to 25 basis points during the extension period. The second proposed alternative also would provide insured depository institutions participating in the TAGP with a one-time opportunity to opt out of the extended TAGP on or before October 31, 2009.

Comments are due no later than July 30, 2009.

### **SEC Staff Provides No-Action Relief for Fund Purchasers of Asset-Backed Securities through the Term-Asset Backed Loan Facility**

The staff of the SEC's Division of Investment Management (the "Staff") provided no-action assurances to registered funds permitting them to invest in the Term-Asset Backed Securities Loan Facility ("TALF") under certain conditions without treating the borrowing as a senior security and without requiring the program's unique collateral arrangement to fully comply with the custody requirements under the Investment Company Act of 1940, as amended (the "1940 Act"). As more fully described in the [December 2, 2008 Alert](#) and the [May 5, 2009 Alert](#), the TALF program was established by the Department of the Treasury and the Federal Reserve Board to increase the credit available in the markets by supporting the issuance of various types of asset-backed securities ("ABS") through the provision of loans to ABS purchasers. Under the program, the Federal Reserve Bank of New York ("FRBNY") provides non-recourse loans to eligible U.S. holders of certain AAA-rated ABS less a slight haircut (between 5 and 16% of the loan depending on the types of ABS purchased). The loans are secured at all times by the ABS, which are to be transferred to a participating "primary dealer" chosen by the purchaser and delivered at the loan closing to the Bank of New York Mellon ("BNY Mellon") as administrator and custodian of the TALF program. The non-recourse nature of a loan means that, in the event that a purchaser does not repay a loan, the purchaser will incur no financial obligation beyond the loss of the collateral.

*Senior Securities.* The no-action relief was prompted by concerns that participation in the TALF program could raise issues for registered funds under Section 18 of the 1940 Act, which limits the extent to which registered open-end and closed-end funds may issue senior securities. Section 18(g), in part, defines a "senior security" as "any bond, debenture, note, or similar obligation or instrument constituting a security and evidencing indebtedness." Under Section 18, open-end funds are generally prohibited from issuing senior securities, except for bank borrowings constituting one third or less of the fund's net assets after the borrowing. Closed-end funds may issue senior securities in the form of equity or debt but are limited to one class of each and subject to asset coverage requirements that limit the amount of senior securities a fund may issue. The Staff has taken a broad view of what constitutes a senior security. The no-action relief addresses the concern that the TALF loans, as evidences of indebtedness, may be deemed senior securities subject to the restrictions of Section 18.

The request for relief cited the SEC's position under which a fund engaging in a reverse repurchase agreement could address the Section 18 concerns raised by the arrangement if it "covered" its full obligations under the agreement by establishing and maintaining certain segregated accounts. The request reasoned that the arrangements for TALF loans were analogous to those for reverse repurchase agreements in that both would entail, in economic reality, loans to a fund secured by underlying securities. The request proposed to segregate liquid assets that would be marked-to-market daily to "cover" a fund's obligations under the TALF loan in a manner akin to the way in which reverse repurchase agreements may be covered. The segregated amount would be in addition to the ABS collateral deposited with the primary dealer. Additional liquid assets would be added to the segregated assets whenever the segregated amount falls below the fund's obligations under the TALF loan. Accordingly, a fund investing in the TALF program would have asset coverage of at least 200% at all times.

*Custody.* Section 17(f) of the 1940 Act and the rules thereunder specify the manner in which a fund's assets must be custodied and includes differing requirements depending on whether the assets are held at a bank, broker-dealer or with the fund itself. Although pledged in connection with a TALF loan, a fund's ABS collateral would continue to be fund holdings and thus subject to Section 17(f) custody requirements. Under the TALF program, a fund may only engage in transactions through a primary dealer with which it must initially deposit its eligible collateral. The request for relief was prompted by concerns that the manner in which a primary dealer held fund assets might not comply with Section 17(f) and the rules thereunder, *e.g.*, a primary dealer that is a broker-dealer would likely find it impractical to physically separate a fund's TALF collateral from the assets of other customers as required under Rule 17f-1.

*Conditions.* Without expressing any legal conclusions on the issues presented, the Staff acknowledged the intent of the TALF program and provided no-action assurances to any open-end or closed-end fund participating in the TALF program based on certain representations, including that: (1) the fund's participation in the TALF program is governed by the TALF standing loan procedures (the "Procedures") and master loan and security agreement executed by a primary dealer as agent to the fund with the FRBNY and BNY Mellon; (2) the borrowing by the fund will be collateralized solely by "eligible securities" as defined in the Procedures, the FRBNY can only enforce its rights against those "eligible securities" despite any changes in the value or ratings of such assets, and the TALF loan may be pre-paid at any time by the fund at no penalty; (3) the fund will segregate liquid assets in an amount equal to the fund's obligations under the TALF loan, will not use the eligible securities collateral to meet such segregation requirements and will add additional liquid assets whenever the value of the segregated assets drops below the amount of the fund's obligation under the TALF loan; and (4) the investment in the eligible securities and borrowing under the TALF program is consistent with the fund's investment objective, policies and limitations as stated in its registration statement.

## **FRB Extends and Modifies Liquidity Programs**

The FRB made changes to a number of its extraordinary lending programs, extending many into next year while also closing one and shrinking others. Originally set to expire October 31, 2009, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF"), the Commercial Paper Funding Facility ("CPFF"), the Primary Dealer Credit Facility ("PDCF"), and the Term Securities Lending Facility ("TSLF") were extended through February 1, 2010. The FRB also extended its temporary

reciprocal currency arrangements with 14 other central banks until February 1, 2010. The FRB did not alter the December 31, 2009 expiration date for the Term Asset-Backed Securities Loan Facility.

Though usage of the AMLF has declined considerably, the FRB stated that the AMLF would continue because of ongoing market fragility. However, in order to ensure the AMLF is used as intended, *i.e.*, to provide a temporary liquidity backstop to money market mutual funds, the FRB established a redemption threshold under which a money market mutual fund would have to lose at least 5 percent of net assets in a single day or 10 percent over the prior five business days before it can access the AMLF. The FRB also extended the CPFF through February 1, 2010 to help ensure short-term funding access for U.S. businesses, even though the CPFF is seeing declining usage as its rates become less attractive to many borrowers. With the AMLF and CPFF still in place, the FRB opted not to renew the Money Market Investor Funding Facility, which was never used and will expire on October 31, 2009.

The FRB suspended TSLF auctions backed by Schedule 1 collateral (which includes Treasury securities, agency debt, and agency mortgage-backed securities eligible for tri-party repurchase agreements arranged by the Federal Reserve Bank of New York's Open Market Trading Desk ) and the TSLF Options Program ("TOP"). There have been no bids since March for one-month securities loans in exchange for Schedule 1 collateral. Recently, the TOP has also failed to attract interest. The FRB will continue with TSLF auctions for Schedule 2 collateral, which includes Schedule 1 collateral plus investment-grade corporate, municipal, mortgage-backed, and asset-backed securities. TSLF auctions backed by Schedule 2 collateral will now be conducted every four weeks, rather than every two weeks, and the total amount offered under the TSLF will be reduced to \$75 billion. Even though no obligations are currently outstanding under the PDCF, it is being extended as a liquidity backstop.

The FRB also announced that the amounts auctioned at the biweekly auctions of the Term Auction Facility ("TAF") will be reduced to \$125 billion from \$150 billion, effective with the July 13 auction. The FRB indicated that amounts available under the TAF, which has no scheduled end date, could be lowered further at a gradual rate. Though its usage is declining, the FRB is extending its dollar liquidity swap arrangements through February 1, 2010 with the central banks of Australia, Brazil, Canada, Denmark, the United Kingdom, the European Union, Korea, Mexico, New Zealand, Norway, Singapore, Sweden and Switzerland. Foreign currency swap lines are also being extended with the Bank of England, the European Central Bank and the Swiss National Bank. Separately, the Bank of Japan is still considering whether to extend its swap arrangements.

### **Treasury Announces Warrant Repurchase and Disposition Process for the Capital Purchase Program**

The Treasury announced its policy for the disposition of warrants received in connection with investments made under the Capital Purchase Program ("CPP"). For a further discussion of the CPP, please see the [October 14, 2008](#), [October 21, 2008](#) and [October 27, 2008 Alerts](#). Under the CPP, the Treasury received warrants in the institutions receiving funds. In the case of investments in publicly-traded institutions, the Treasury received warrants to purchase common shares ("CPP Warrants"); these CPP Warrants have not been exercised. In the case of institutions that are not publicly-traded, Treasury received

warrants to purchase preferred stock or debt; these warrants are no longer outstanding because they were exercised immediately upon closing the initial investment.

When a publicly-traded institution repays the Treasury's CPP investment, the original contract under the CPP provides the institution with a right to repurchase the CPP Warrants at fair market value via an independent valuation process.

The Treasury announced the following process for repurchases of CPP Warrants:

Step 1: Within 15 days of repayment, an institution wishing to repurchase CPP Warrants should submit a determination of the fair market value of its CPP Warrants to the Treasury.

Step 2: The Treasury will then have 10 days to determine whether or not to accept the institution's initial determination.

Step 3: If the Treasury objects to the institution's determination and cannot reach agreement with the bank regarding fair market value of the CPP Warrants, the institution and the Treasury will each select an independent appraiser. These independent appraisers will conduct their own valuations and attempt to agree upon the fair market value of the CPP Warrants.

Step 4: If these appraisers fail to agree, a third appraiser will be hired, and subject to certain limitations, a composite valuation of the three appraisals is used to establish the fair market value of the CPP Warrants.

The Treasury stated that it will base its determination of the value of the CPP Warrants on three categories of input: (1) market prices, (2) financial modeling and (3) outside consultants and financial agents. If an institution chooses not to repurchase the CPP Warrants according to its existing contractual rights, the Treasury has the discretion to dispose of the CPP Warrants as it sees fit over time. In these instances, the Treasury states that it will sell the CPP Warrants through an auction process over the next few months. The Treasury indicated that it is currently establishing guidelines for these auctions. The Treasury further stated that it will begin publishing additional information on each warrant that is repurchased, including the institution's initial and subsequent determinations of fair market value, if applicable. Following the completion of each repurchase, the Treasury will also publish the independent valuation inputs used to assess the institution's determination of fair market value.

**OTHER ITEM OF NOTE**

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**Goodwin Procter Issues ERISA Litigation Update**

[Goodwin Procter's ERISA Litigation Practice](http://www.goodwinprocter.com/~media/8A1CF2C387CF43D8B0CCE3F204DCE42F.ashx) has issued an update discussing recent developments in ERISA litigation, which is available at <http://www.goodwinprocter.com/~media/8A1CF2C387CF43D8B0CCE3F204DCE42F.ashx>. The update covers the Seventh Circuit's denial of petitions for panel rehearing and rehearing *en banc* in *Hecker v. Deere & Co.*, ERISA-related litigation involving securities lending, joint SEC/DOL hearings on target date funds and the importance of plan terms in independent contractor ERISA suits, and provides a listing of upcoming conferences.