

## **Razor Alert**



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## **Financial Services Update**

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This Razor Alert incorporates recent developments made in the Financial Services area. It is separated into the following sections:

- Governance, Compensation, and Disclosure
- Fees and Limits on Banks
- Money Market Funds
- Derivatives and Asset Backed Securities
- FDIC and Private Capital
- Truth in Lending
- SEC Cooperation Initiatives
- Discount Windows

### **Governance, Compensation, and Disclosure**

#### **SEC Approves Enhanced Disclosure About Risk, Compensation and Corporate Governance**

The Securities and Exchange Commission today approved rules to enhance the information provided to shareholders so they are better able to evaluate the leadership of public companies.

The new rules require disclosures in proxy and information statements about:

- The relationship of a company's compensation policies and practices to risk management. Specifically, the Commission's approved rules will require disclosure of a company's compensation policies for all employees and practices as they relate to the company's risk management if the compensation policies and practices create risks that are reasonably likely to have a material adverse effect on the company. Smaller reporting companies will not be required to provide the new disclosure.
- The background and qualifications of directors and nominees. The SEC approved new rules to improve information about directors and nominees for director. The new requirements include for each director and director nominee, disclosure of :  
qualifications, past directorships, expanded list of legal proceedings, such as SEC

securities fraud enforcement actions against the director or nominee, going back 10 years; the particular experience, qualifications, attributes, or skills that led the company's board to conclude that the person should serve as a director of the company; an/or any directorships at public companies and registered investment companies that each director and director nominee held at any time during the past five years.

- Legal actions involving a company's executive officers, directors and nominees. If the nominating committee or the board has a policy with regard to the consideration of diversity in identifying director nominees, the final rules require disclosure of how this policy is implemented and how the nominating committee or the board assesses the effectiveness of its policy.
- The consideration of diversity in the process by which candidates for director are considered for nomination.
- Board leadership structure and the board's role in risk oversight.
- Stock and option awards to company executives and directors. The amended rule requires companies to report the value of options when they are awarded to executives (the aggregate grant date fair value), instead of the current requirement to report the annual accounting charge. A special instruction addresses performance based awards to address concerns that the new rule might discourage use of these awards.
- Potential conflicts of interests of compensation consultants by requiring disclosure of compensation in certain circumstances.

The new rules, which will be effective Feb. 28, 2010, also require quicker reporting of shareholder voting results.

### **SEC To Provide Guidance on Climate Change Disclosures**

The SEC approved the release of climate change disclosure interpretive guidance clarifying the existing climate risk disclosure obligations of public companies listing on U.S. stock exchanges.

### **SEC Removes Roadblocks to Use of Non-GAAP Measures in Filings**

New SEC staff guidance published this month indicates a more nuanced and sophisticated view of non-GAAP measures than has tended to apply since Regulation G prohibits the misleading use of non-GAAP measures and that requires that these measures be reconciled to the corresponding GAAP measures. New Compliance & Disclosures Interpretations (C&DIs) replace previously published interpretations and permit companies to use non-GAAP measures to exclude even items that do not meet the SEC definition of "nonrecurring". Item 10(e) of Regulation S-K, regarding non-GAAP measures in SEC filings, provides that an issuer may not adjust, eliminate, or smooth items identified as non-recurring, infrequent or unusual, where the nature of the charge or gain is such that it is reasonably likely to recur within two years or there was a similar charge or gain within the prior two years.

### **Incorporate Compensation Programs into the Risk-Based Deposit Insurance Assessment System, Disclosures, Risk Management Programs**

The FDIC Board proposes that compensation policies should be incorporated as a factor in the risk-based insurance premiums charged to insured depository institutions to reduce excessively risky behavior that pose risks to the depository institution and its stakeholders, including the

Deposit Insurance Fund. The Federal Reserve announced in October 2009 a new regulatory framework intended to address risky incentive compensation practices at financial institutions. The SEC finalized its rule to require all public companies to disclose more information about how they compensate their employees, including disclosure on how risks arising from a company's compensation arrangements are reasonably likely to have a material adverse effect on the company. The House Financial Services Committee has held hearings on compensation practices for both financial and non-financial firms, after successfully passing compensation measures as a part of H.R. 4173, the Wall Street Reform and Consumer Protection Act.

### **SEC Proposes Rule Amendments to Facilitate Access to Capital Markets**

The SEC announced proposed amendments to Rule 163 to further facilitate the ability of certain large companies to communicate with broader groups of potential investors and gauge the level of interest in the market for their securities offerings so "well-known seasoned issuers" may authorize an underwriter or dealer to communicate with potential investors on their behalf about potential securities offerings prior to filing registration statements for such offerings.

### **Fees and Limits on Banks**

#### **President Obama Calls for New Restrictions on Size and Scope of Financial Institutions to Rein in Excesses and Protect Taxpayers**

The proposal would:

1. Limit the scope to ensure that no bank or financial institution that contains a bank will own, invest in, or sponsor a hedge fund or a private equity fund, or proprietary trading operations unrelated to serving customers for its own profit.
2. Limit the Size to limit the consolidation of our financial sector, placing broader limits on the excessive growth of the market share of liabilities at the largest financial firms and to supplement existing caps on the market share of deposits.

#### **The Financial Crisis Responsibility Fee**

The President proposed a Financial Crisis Responsibility Fee to require the largest and most highly levered Wall Street firms to pay back taxpayers for the extraordinary assistance provided so that the TARP program does not add to the deficit. The fee would: (1) require the financial sector to pay back for the extraordinary benefits received; (2) require the responsibility fee to remain in place for 10 years or longer if necessary to fully pay back TARP; (3) raise up to \$117 billion to repay projected cost of TARP; (4) provide a plan for taxpayer repayment three years earlier than required; and (5) apply to the largest and most highly levered firms.

### **Money Market Funds**

#### **SEC Approves Money Market Fund Reforms to Better Protect Investors**

The SEC adopted new rules designed to strengthen the regulatory requirements governing money market funds and better protect investors. The SEC's new rules are intended to increase the resilience of money market funds to economic stresses and reduce the risks of runs on the funds by tightening the maturity and credit quality standards and imposing new liquidity requirements.

#### **Further Restricting Risks by Money Market Funds**

**Improved Liquidity:** The new rules require money market funds to have a minimum percentage of their assets in highly liquid securities to allow for quick liquidation into cash to

pay redeeming shareholders. Currently, there are no minimum liquidity mandates. On a daily basis, at least 10 percent of assets must be in cash, U.S. Treasury securities, or securities that convert into cash (e.g., mature) within one day. On a weekly basis, at least 30 percent of assets must be in cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, or securities that convert into cash within one week.

The rules would further restrict the ability of money market funds to purchase illiquid securities (any security that cannot be sold or disposed of within seven days at carrying value) by restricting money market funds from purchasing illiquid securities if more than 5 percent of the fund's portfolio will be illiquid securities.

**Higher Credit Quality:** A fund may not invest more than 3% (currently 5%) of its assets in Second Tier securities. A fund may not invest more than ½ of 1% of its assets in Second Tier securities issued by any single issuer and may not buy Second Tier securities that mature in more than 45 days.

**Shorter Maturity Limits:** A fund must restrict the maximum "weighted average life" maturity of its portfolio to 120 days, to limit the ability of the fund to invest in long-term floating rate securities and must restrict the maximum weighted average maturity of a fund's portfolio to 60 days.

**"Know Your Investor" Procedures:** Funds must hold sufficiently liquid securities to meet foreseeable redemptions by identifying investors whose redemption requests may pose risks for funds and by anticipating the likelihood of large redemptions.

**Periodic Stress Tests:** Fund managers must examine the fund's ability to maintain a stable net asset value per share in the event of shocks - such as interest rate changes, higher redemptions, and changes in credit quality of the portfolio.

**Nationally Recognized Statistical Rating Organizations (NRSROs):** A money market fund's investment may only invest in rated securities to those securities rated in the top two rating categories and must perform an independent credit analysis of every security purchased. As such, the credit rating serves as a screen on credit quality, but can never be the sole factor in determining whether a security is appropriate for a money market fund. Funds must designate each year at least four NRSROs whose ratings the fund's board considers to be reliable. Funds are not restricted to invest only in those asset backed securities that have been rated by an NRSRO.

**Repurchase Agreements:** A money market fund may "look through" the repurchase issuer to the underlying collateral securities for diversification purposes. Collateral must be cash items or government securities (as opposed to the current requirement of highly rated securities). The fund must evaluate the creditworthiness of the repurchase counterparty.

### **Enhancing Disclosure of Portfolio Securities**

**Monthly Web Site Posting:** Money market funds each month must post on their Web sites their portfolio holdings.

**Monthly Reporting:** Money market funds each month must report to the Commission detailed portfolio schedules in a format that can be used to create an interactive database through which the Commission can better oversee the activities of money market funds,

including a money market fund's "shadow" NAV, or the mark-to-market value of the fund's net assets, rather than the stable \$1.00 NAV at which shareholder transactions occur.

### **Improving Money Market Fund Operations**

***Processing of Transactions:*** Money market funds and their administrators must be able to process purchases and redemptions electronically at a price other than \$1.00 per share, in case it were to break the buck.

***Suspension of Redemptions:*** Money market fund's board of directors may suspend redemptions if the fund is about to break the buck and decides to liquidate the fund without an order from the SEC to suspend redemptions for an orderly liquidation of the portfolio.

***Purchases by Affiliates:*** Affiliates of money market funds may purchase distressed assets from funds in order to protect a fund from losses subject to notice to the SEC. Currently, an affiliate cannot purchase securities from the fund before a ratings downgrade or a default of the securities - unless it receives individual approval.

### **Derivatives and Asset Backed Securities**

#### **CFTC Grants ICE Clear Europe Limited Registration as Derivatives Clearing Organization**

The Commodity Futures Trading Commission allowed ICE Clear Europe Limited to register as a derivatives clearing organization authorized to clear futures contracts, options on futures contracts, commodity options and over-the-counter derivative contracts. ICE Clear Europe operates within the United States as a multilateral clearing organization clearing energy-based contracts and credit default swap contracts on European reference entities.

#### **Agencies Issue Final Rule for Regulatory Capital Standards Related to Statements of Financial Accounting Standards Nos. 166 and 167**

The federal banking and thrift regulatory agencies adopted a risk-based capital rule related to the Financial Accounting Standards Board's adoption of Statements of Financial Accounting Standards Nos. 166 and 167. The FASB standards make substantive changes to how banking organizations account for many items, including securitized assets, that had been previously excluded from these organizations' balance sheets. Consequently, banking organizations affected by the new accounting standards generally will be subject to higher risk-based regulatory capital requirements. The rule better aligns risk-based capital requirements with the actual risks of certain exposures. It also provides an optional phase-in for four quarters of the impact on risk-weighted assets and tier 2 capital resulting from a banking organization's implementation of the new accounting standards.

#### **CFTC Seeks Public Comment on Proposed Regulations Regarding Retail FOREX Transactions**

The CFTC proposed regulations concerning off-exchange retail foreign currency transactions (1) clarifying the scope of the CFTC's anti-fraud authority with respect to retail off-exchange foreign currency transactions; (2) providing the CFTC with the authority to register entities wishing to serve as counterparties to retail forex transactions as well as those who solicit orders, exercise discretionary trading authority and operate pools with respect to retail off-exchange foreign currency transactions; and (3) mandating minimum capital, operations, and recordkeeping requirements for entities serving as counterparties to such transactions.

## **Proposed new US reporting and withholding rules for non-US securitization vehicles**

The US House of Representatives has passed provisions intended to tighten the enforcement of US tax laws, including new reporting and withholding rules for foreign (i.e. non-US) financial institutions and other entities, including certain foreign securitization vehicles, to address concerns stemming from incidents of US persons failing to report foreign account information. The rules would cover securitization vehicles as special purpose entities set up without an independent operations function and are structured to remove sources of risk which may reduce the anticipated and modeled cash flows.

## **FDIC and Private Capital**

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The FDIC will now presume that, if more than two-thirds of the total voting stock of an insured depository institution or its holding company that acquires a failed bank or thrift is held by private investors that each own 5% or less of the voting stock, the private investors are acting in concert as a single investor group. This position seems to confirm the FDIC's preference for transactions in which an existing bank holding company owns at least two-thirds of the voting stock of the acquiring depository institution or its holding company or is itself the acquirer (with new private investors limited to no more than one-third of the existing bank holding company's total equity).

## **Truth in Lending**

### **FED Approves a Final Rule Amending Regulation Z**

The Federal Reserve Board approved an amendment to Regulation Z (Truth in Lending) to protect consumers who use credit cards. Credit card issuers must (1) not increase a rate during the first year after an account is opened and increase a rate that applies to an existing credit card balance; (2) not issue a credit card to a consumer who is younger than the age of 21 unless the consumer has the ability to make the required payments or obtains the signature of a parent or other cosigner with the ability to do so; (3) obtain a consumer's consent before charging fees for transactions that exceed the credit limit; (4) limit the high fees associated with subprime credit cards; (5) not use the "two-cycle" billing method to impose interest charges; and (6) not allocate payments in ways that maximize interest charges.

## **SEC Cooperation Initiatives**

### **SEC Enforcement Division Releases Detailed Information Regarding Cooperation Initiatives**

The Securities and Exchange Commission ("SEC") recently unveiled new tools designed to help the SEC Staff accelerate investigative proceedings. For the first time, the SEC has now (1) announced guidelines for assessing individual cooperation in investigations and enforcement actions, and (2) authorized the Director to seek immunity for cooperating witnesses directly from the Department of Justice ("DOJ"). The framework for evaluating cooperation by corporations, which uses the corporation's level of cooperation with the Staff in disclosing wrongdoing and providing evidence as a relevant factor in deciding whether to prosecute corporations, has been outlined by the SEC and DOJ since 2001 while the SEC has only now articulated parallel criteria to consider relating to cooperation by individuals. The SEC's new policy statement is intended to help the SEC and defense counsel use common criteria in weighing the value of potential cooperators.

## **Discount Window**

### **FED Modifies the Terms of its Discount Window Lending Program**

The Federal Reserve Board has approved several modifications to the terms of its discount window lending programs. These changes are intended as a further normalization of the Federal Reserve's lending facilities. The modifications are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy.

### **Risk Metrics' Governance Risk Indicators – a New Governance Measurement for Proxy Voting Reports**

Risk Metrics Group has recently overhauled its core corporate governance yardstick and the changes for US companies include: (1) the discontinuation of the Corporate Governance Quotient (CGQ); (2) the adoption of a new approach called Governance Risk Indicators GRId; and (3) the abandonment of its practice of "certifying" director education programs.

### **FINRA Proposes Changes to New and Continuing Membership Application Processes**

The Financial Industry Regulatory Authority ("FINRA") proposed rules that would govern FINRA's New Membership Application ("NMA") and Continuing Membership Application ("CMA") processes including (i) detailed information on the applicant's Affiliates, (ii) expand the categories of changes that would trigger a CMA filing, and (iii) institute new advance notice requirements for certain significant events that do not trigger a CMA.