

Financial Services Regulatory Highlights

volume 10 no. 8 August 2008

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FINRA and NYSE Regulation Announce Agreement with Ten US Exchanges to Strengthen Surveillance, Investigation and Enforcement to Prevent Insider Trading

FINRA and NYSE Regulation, Inc., announced an agreement with ten U.S. exchanges to strengthen investor protection by consolidating the surveillance, investigation and enforcement of insider trading in equity securities. Under the agreement, each exchange gives responsibility for the detection of insider trading to FINRA for AMEX and NASDAQ listed securities, and to NYSE Regulation for New York Stock Exchange and NYSE Arca listed securities, no matter where trading occurs in the United States.

Market centers participating in the agreement, which has been filed with the SEC for approval, are the American Stock Exchange, the Boston Stock Exchange, the CBOE, the Chicago Stock Exchange, the International Securities Exchange, the NASDAQ Stock Market, the National Stock Exchange, the New York Stock Exchange, NYSE Arca, the Philadelphia Stock Exchange and FINRA.

Currently, each exchange conducts its own regulatory insider trading program and relies upon cooperation with other exchanges when potential insider trading is detected. This agreement will take insider trading surveillance to a new level by consolidating what used to be separate surveillance centers into one within FINRA and NYSE Regulation.

SEC Approves BATS as a National Securities Exchange

On August 18, 2008, BATS received approval from the SEC to operate a national securities exchange. Better Alternative Trading System, or BATS, filed for exchange status in November 2007. BATS Trading, which currently operates the BATS ECN, has steadily captured market share of NYSE and Nasdaq listed securities since its launch in January 2006. The SEC's approval of this application marks the first time that an established ECN has successfully filed for the transition to full national securities exchange status. BATS is owned by affiliates of Citi, Credit Suisse, Deutsche Bank, GETCO, JP Morgan, Lehman Brothers and Morgan Stanley, among others.

Background

Converting to an exchange will take approximately two months and will allow BATS to directly compete with the New York Stock Exchange and the Nasdaq Stock Market. Currently, BATS ECN must quote through a national securities exchange. With this conversion, BATS will disseminate quotations directly to the marketplace. Since its launch, BATS ECN has increased its market share by offering efficient execution of orders and discounts on trading fees. BATS currently trades about 10% of the daily volume in Nasdaq and NYSE listed securities and will likely increase its market share as a result of gaining exchange status.

Structure

BATS Holdings will wholly own BATS Exchange and BATS Trading. The assets of BATS trading will be transferred to BATS Exchange prior to operation of BATS Exchange. BATS Trading will continue as a broker-dealer to provide outbound order routing services to BATS Exchange. BATS Exchange will operate a fully automated electronic order book.

SRO Obligation

As a national securities exchange, BATS will be a self-regulatory organization (SRO) responsible for ensuring that its members and the persons associated with its members comply with federal securities laws and the rules of the exchange. The SEC determined that BATS' proposed rules are consistent with the Securities Exchange Act of 1934 Act in that they are designed to 1) assure fair representation of the exchange's members in the selection of directors, 2) prevent fraudulent and manipulative acts and practices and 3) protect investors and the public interest.

To meet its obligation as an SRO, BATS has entered into an agreement with FINRA who will perform certain regulatory functions on behalf of the BATS Exchange. Specifically, FINRA will assist with registration issues, investigations of potential violations of exchange rules and federal securities laws, examinations related to member's market conduct and disciplinary proceedings.

Membership

Membership to the BATS Exchange will be open to any registered broker dealer that is a member of another national securities exchange or association. Exchange members and entities that enter into sponsorship arrangements with Exchange members will have access to the BATS Exchange system.

SEC Proposes Guidance to Fund Boards Regarding Oversight of Investment Adviser Trading of Portfolio Securities, Use of Soft Dollars

On July 30, 2008 the SEC issued proposed guidance to boards of directors of registered investment companies to assist them in fulfilling their fiduciary responsibilities with respect to overseeing the trading of investment company portfolio securities.

The guidance focuses on investment adviser's use of soft dollars, the fund boards of directors responsibility to oversee the adviser's satisfaction of its best execution obligations, including the adviser's use of fund brokerage commissions and the overall transaction costs that the fund incurs when the fund buys or sells portfolio securities.

Fund directors play a pivotal role in overseeing conflicts of interest investment advisers face when they have funds as clients. The fund's directors must understand and scrutinize the payment of transaction costs by the fund and determine if each payment of these transactions costs are in the best interests of clients.

As a fiduciary, an investment adviser has the duty to seek best execution of securities transactions it conducts on the fund's behalf. Investment advisers must execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances. Commission rates or spreads are not the only factors to determine best execution; the value of research provided, execution capability,

financial responsibility and responsiveness to the adviser are other factors to consider.

When trading portfolio securities on behalf of clients that are funds, there are a number of ways in which an investment adviser may use a portion of fund brokerage commission to benefit the fund beyond execution of the securities transactions. An adviser may use a portion of fund brokerage commissions to purchase research. Advisers may also purchase third party research themselves using cash payments or "hard dollars". Additionally, advisers may obtain proprietary and third party research through a client commission arrangement. In client commission arrangements, the adviser agrees with a broker-dealer effecting trades for the adviser's client accounts that a portion of the commissions paid by the accounts will be credited to purchase research from the executing broker or another broker.

Comments on the proposed guidance should be submitted to the SEC by October 1, 2008.

SEC Proposes Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies

The SEC is reopening for comment the proposed rule which is intended to enhance the disclosures that are provided to mutual fund investors. Specifically, the rule proposal would require key information to appear in plain English in a standardized order at the front of the mutual fund prospectus and permit a person to satisfy its

mutual fund prospectus delivery obligations by sending or giving the key information directly to investors in the form of a summary prospectus and providing the statutory prospectus on an Internet Web Site.

SEC Announces Successor to EDGAR Database

On August 19, 2008, the SEC announced the successor to the longstanding EDGAR database. The new SEC system IDEA, short for Interactive Data Electronic Applications, will give investors faster and easier access to key financial information about public companies and mutual funds. It will first be used to supplement and then eventually replace the EDGAR system.

With IDEA, investors will be able to instantly collate information from thousands of companies and create reports and analysis in any way they choose. The SEC has formally proposed requiring US companies to provide financial information using interactive data beginning as early as next year. Separately, the SEC has proposed requiring mutual funds to submit their public filings using interactive data.

Interactive data relies on computer tags, similar to bar codes that identify individual items in a company's financial disclosures. Every

number on any company's financial statements and other information about thousands of companies could easily be searched on the Internet, downloaded into spreadsheets, and be used by investors and analysts for comparative or analytical purposes.

Investors and others who currently use EDGAR will be able to continue to do so for the indefinite future. Companies' interactive data filings are expected to be available through IDEA beginning later this year. The EDGAR database will also continue to be available as an archive of company filings for past years.

FDIC Implements Loan Modification Program for Distressed IndyMac Mortgage Loan

On August 20, 2008, FDIC Chairman Sheila C. Bair announced that IndyMac Federal Bank, FSB will implement a new program to systematically modify troubled mortgages. The program is designed to achieve affordable and sustainable mortgage payments for borrowers and increase the value of distressed mortgages by rehabilitating them into performing loans. This in turn will maximize value for the FDIC as well as improve returns to the creditors of the former IndyMac Bank and to investors in those mortgages. The new program will help IndyMac Federal improve its mortgage portfolio and servicing by modifying troubled mortgages, where appropriate, into performing mortgages.

The former IndyMac Bank, F.S.B. Pasadena, California, was closed on July 11th by the Office of Thrift Supervision and the FDIC was appointed as receiver. On the same day, the FDIC was named conservator for a new institution, IndyMac Federal Bank, FSB.

IndyMac Federal is focusing first on helping those borrowers with mortgages that are seriously delinquent or in default, but will seek to work with others who are unable to pay their mortgages due to

payment resets or changes in the borrowers' repayment capacities. Based on this analysis, IndyMac Federal will extend proposed modification offers to borrowers for modifications or other loss mitigation designed to achieve affordable, long-term payments. IndyMac Federal will send an estimated 4,000 modification proposals to borrowers this week and thousands of additional proposals in the coming weeks. Once a borrower receives a modification proposal, he or she should begin making the modified payments and provide information to verify his or her income. Finalization of the modification agreement is contingent on the borrower providing information to allow verification of income to confirm that he or she qualifies for the proposed modification.

IndyMac Federal will only make modification offers to borrowers where doing so will achieve an improved value for IndyMac Federal or for investors in securitized or whole loans. Modification offers will be provided consistent with agreements governing servicing for

loans serviced by IndyMac Federal for others. The modification program does not guarantee a modification offer for IndyMac Federal borrowers.

OCC Interim Final Rule Encourages Public Welfare Investments by National Banks

The Office of the Comptroller of the Currency (OCC) issued on August 21, 2008 an interim final rule to implement the changes to national banks' public welfare investment authority enacted in the Housing and Economic Recovery Act of 2008 (HERA), which the President signed into law on July 30, 2008. This provision in HERA restored national banks' full authority to make investments designed primarily to promote the public welfare, including in low- and moderate-income communities, communities affected by foreclosures and targeted for revitalization, designated disaster areas, and underserved rural communities. The OCC recognized the need to implement this provision promptly.

"This has the potential to generate additional private investments that will go toward strengthening and stabilizing our communities, and we greatly appreciate the leadership in Congress for restoring

this valuable authority," Comptroller Dugan said. "The public welfare investment provision of the legislation, as implemented by the OCC's regulation, provides support for the goals of the housing bill, without the expenditure of any taxpayer funds, by helping to revitalize and stabilize communities affected by rising foreclosures."

Although there is a 30-day public comment period, the interim final rule became effective on August 11 when it was published in the Federal Register. The comment period closes on September 10, 2008.

OTS Launches Redesigned Website

The Office of Thrift Supervision (OTS) launched a new website in early August that greatly enhances the availability of OTS information to the public.

The website at www.ots.treas.gov has a new design, added content, improved organization and enhanced features, including fresh ways to highlight timely and important news for consumers, thrift institutions and others.

The site has expanded information about the OTS and its history, including a new section about each of the five OTS regions, as well as a revised section on the OTS Ombudsman. The website also unveils a new e-filing feature for filing certain types of charter-related applications electronically.

CFTC Launches Task Force on Fraud in the Off-Exchange Retail Foreign Currency Market

The Commodity Futures Trading Commission (CFTC) announced on August 11, 2008 the formation of a special task force to investigate and litigate fraud in the off-exchange retail foreign currency market. The task force will focus on fraud in the retail forex

market and will work cooperatively with other federal and state regulatory and criminal authorities. "The formation of the CFTC's new Forex Enforcement Task Force reaffirms the

agency's commitment to stopping unscrupulous individuals working in this space. Not only do forex fraudsters prey upon unsuspecting citizens, but their illegal activities taint the reputations of those working honestly in the futures industry," said CFTC Commissioner

Michael Dunn, who leads the agency's Forex Education and Outreach Task Force.

An Interagency Notice of Proposed Rulemaking (NPR) on the Implementation of a Standardized Basel II Approach

In this Interagency notice the NPR outlines a Basel II approach which increases risk sensitivity on the minimum capital requirements established under Basel I. For national banks, which under Basel I were not required to use the advanced risk-based capital rules, the NPR identifies a new approach. Eligible banks will have the option of continuing to operate under the general risk-based capital rules or choosing a standardized capital framework, which was outlined in the NPR. This standardized approach includes risk based capital

requirements for assessing operational risk as well as disclosure requirements.

New York Governor Paterson Signs Comprehensive Reforms to Address Foreclosure Crisis

On August 5, 2008, Governor David A. Paterson of New York signed into law a subprime lending reform bill which directly addresses the mortgage crisis in New York State.

The legislation works in two ways: immediately helping to prevent New Yorkers from losing their homes by assisting those who are currently facing foreclosure, and by attacking flaws in New York's banking regulations to prevent such a crisis from happening again.

"We have still seen thousands of our families lose their homes, and no state has been hit harder by the broader effects of the lending crisis. Wall Street's woes have helped to drive New York into recession," said Governor Paterson. "We have the responsibility to protect New York's families who are facing foreclosure, and we need to reform banking regulations to ensure this does not happen again. This law does both, and spurred the federal government to do the same."

Data from the New York State Banking Department shows that approximately one in 200 New York homes is in the foreclosure process. Some areas of New York – such as Queens, Brooklyn and Long Island, and in Upstate New York, Monroe and Albany counties – are being disproportionately impacted.

The immediate focus of the bill is on existing homeowners facing foreclosure. The bill requires lenders to send a pre-foreclosure notice to borrowers at least 90 days before foreclosure proceedings may be initiated. This will encourage homeowners to seek help prior to the initiation of foreclosure proceedings. The bill would also require lenders to list in the notice government-approved housing counselors serving the borrower's area.

The bill establishes a mandatory settlement conference for foreclosure proceedings involving homeowners with certain subprime loans. For homeowners who cannot afford an attorney, the court, under certain circumstances, may appoint one.

The bill requires plaintiffs in an action against a homeowner to make an affirmative allegation that they have standing to bring the foreclosure action and have complied with certain applicable laws. Ownership of the mortgage and the note is

sometimes uncertain, which has led to questionable foreclosure practices.

The bill includes provisions to address foreclosure rescue scams intended to take advantage of borrowers when they are most vulnerable. This bill will prohibit upfront fees and require a written contract from so-called “distressed property consultants.”

There are additional elements in the bill that are designed to prevent future crises:

- The bill enacts a new provision in the Banking Law to establish strong consumer protections for subprime loans and minimum underwriting standards that protect borrowers.
- Ascertaining the borrower’s ability to pay is a basic tenet of prudent lending. The bill establishes an ability to pay standard requiring lenders to make a reasonable and good faith determination of the borrower’s ability to repay the loan,

including the principal, interest, taxes, insurance, assessments, points and fees.

- The duty of care feature of the bill requires brokers to act in the borrower’s interest by presenting loans most appropriate for the borrower.
- All mortgage servicers servicing loans on residential property in New York would be required to register with the Banking Department.
- Mortgage fraud would be classified as a crime under the Penal Law, making it easier for prosecutors to pursue cases. As the magnitude of the fraud increases, so would the criminal penalty.

North Carolina Emergency Foreclosure Reduction Legislation

Governor Mike Easley of North Carolina signed into law legislation to reduce home foreclosure filings due to the subprime mortgage crisis during the next two years. The law also prohibits lenders from paying yield spread premiums to brokers on subprime mortgages. The governor said the Emergency Foreclosure Reduction Program could keep more than 25,000 families in their homes and paying their mortgages. The law requires that a notice be sent to the homeowner and the Commissioner of Banks at least 45 days before a foreclosure is filed. During that time, banking commission staff will work with the homeowner and lender to come up with an acceptable

interest rate that the borrower can afford and the bank can accept. The law gives the Bank Commissioner authority to extend any foreclosure filing notice by 30 days, while the state works with a homeowner and mortgage holder to come to agreement on a loan interest rate and payments. Another new law requires individuals and companies serving loans in North Carolina to register and make reports to the Commissioner of Banks.

CSBS, AARMR Join ComplianceEase on Automated Mortgage Examination Product

Two products to help state regulators automate their examination process were released on Wednesday August 20, 2008 at the American Association of Residential Mortgage Regulators Annual Regulatory Conference. ComplianceEase unveiled RegulatorConnect and RegulatorDirect solutions, which will enable state-regulated mortgage lenders and banking institutions to automate the regulatory examination process. RegulatorConnect links institutions with state regulators through electronic data

transfer, while RegulatorDirect enables lenders to deliver electronically compliance audit reports to their state regulators.

At the heart of the new process is ComplianceAnalyzer, which was selected by the Conference of State Bank Supervisors (CSBS) as the automated component of its Model

Examination Guidelines (MEGs) initiative, which has been under way since mid-2007 under the leadership of Chuck Cross, CSBS vice president of Mortgage Regulatory Policy. Cross said the MEGs effort includes a component on ways states can use technology to more thoroughly address safety and soundness and consumer protection issues, review more loans in greater depth, better identify problems, and share information across state lines. A team of 14 state regulators began testing compliance software, choosing LogicEase Solutions, Inc. which developed the ComplianceAnalyzer software program.

"Technology and automated solutions have become essential elements for CSBS to leverage as we seek new ways to standardize and improve regulatory supervision while streamlining the examination process," Cross said. ComplianceAnalyzer will be enhanced with additional state-specific rules and new tests based on requirements from the regulators, he added. The use of this software is free to CSBS and AARMR members.

Insurance Information Act (IIA) Introduced to Create an Office of Insurance Information (OII) at the Federal Level

On April 17, 2008 Congressman Paul Kanjorski (D-PA), Chairman of the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, introduced H.R. 5840, The Insurance Information Act, (IIA) which would establish the Office of Insurance Information (OII). This bill transfers responsibility for all insurance lines with the exception of health insurance to the Department of the Treasury (Treasury) and requires the Head of the OII to report material updates and trends to the appropriate congressional committees. During the June 10, 2008 House Financial Services Committee hearing on H.R. 5840, as well as in resulting commentary from industry organizations, many of the traditional arguments were made both for and against the Federal regulation of insurance. However, some opponents of the Optional Federal Charter (OFC) bill seemed more open to supporting the establishment of the OII. The OFC bill was proposed as part of the National Insurance Act of 2007 by Representatives Melissa Bean (D-IL) and Ed Royce (R-CA) on July 25, 2007. In addition to allowing insurers to choose national or state regulation, the bill also establishes a national insurance regulator within Treasury.

During the H.R. 5840 hearings, Jeremiah O. Norton, Deputy Assistant to the Treasury Secretary made statements in support of both the OII and OFC. Mr. Norton suggested that the OII would provide Federal oversight of the insurance industry, in line with what was outlined on March 31, 2008 in the Treasury's Blueprint for Modernized Financial Regulatory Structure. This document also included support for the establishment of an OFC for insurers. Mr. Norton commented that such efforts would increase efficiency and

competition within the insurance market, predicting a benefit for both consumers and insurers.

Michael T. McRaith, Illinois Director of Insurance, spoke on behalf of the National Association of Insurance Commissioners (NAIC), which has long opposed efforts to pass an OFC bill. He expressed concerns that a Federal regulator of the insurance market could not devote the time and resources necessary to effectively manage compliance and remain current on all relevant regulatory issues. Notably, however, Mr. McRaith expressed conditional support for H.R. 5840, acknowledging that the NAIC is limited regarding its ability to manage international insurance issues. Mr. McRaith's testimony then hit on NAIC concerns including OII preeminence and a fundamental disagreement with Federal preeminence over insurance regulations within the States.

Representative Brian P. Kennedy, a member of the Rhode Island House of Representatives and President of the National Conference of Insurance Legislators (NCOIL) expressed his organization's opposition to H.R. 5840. He particularly opposed the NAIC, a private

organization, acting as a depository for insurance information. Mr. Kennedy also expressed concern that the passage of H.R. 5840 would lay the foundation for the passage of the OFC.

Both the American Council of Life Insurers (ACLI) and the National Association of Professional Insurance Agents (PIA) made statements regarding the bill. The ACLI strongly supported H.R. 5840, stating that "the decisions made in Washington affect all insurance consumers regardless of where they live, and it is time the Federal government developed the institutional expertise to evaluate insurance-related legislation on a national basis." The ACLI also expressed support for the OFC, citing a similar rationale based on improved competition and efficiencies. Meanwhile, the

PIA strongly opposed H.R. 5840, seeing it as a Federal usurpation of the right of the State Departments of Insurance to regulate the insurance industry.

Many OFC opponents are fighting the IIA bill principally because they feel that the IIA is a gateway to passage of the OFC. The debate over the OFC and the IIA is ongoing and highlights the growing polarization between major players in the industry regarding the optimal framework for insurance regulation.

Industry, Regulators Seek to Streamline Communication around Annuities

Both regulators and industry groups are proposing measures to make the sale of annuities more consumer-friendly. Industry professionals, including The American Council of Life Insurers (ACLI) and National Association for Variable Annuities (NAVA) have created an annuities offering document to this effect, and similarly, FINRA has proposed a rule which will require variable annuity providers to clarify product risks and rewards (See FINRA Regulatory Notice 08-39).

ACLI and NAVA have worked together to create a simplified annuities offering document. This 2 1/2 page document is aimed at being an easy-to-understand version of traditional annuities offering documents, allowing for comparisons among annuity products. The document was submitted as part of a pilot program to the National Association of Insurance Commissioners (NAIC). The development of a simplified annuities offering document is in response to increased regulatory scrutiny. While fixed annuities are regulated on a state-by-state basis because of their guaranteed payment schedule, variable annuities are based on the performance of a portfolio of stocks and are regulated by the SEC and FINRA. Recent complaints have included abusive sales practices, lack of adequate disclosures, and abuses targeting seniors.

Separately, the proposed rule submitted for comment by FINRA would require the clear identification of the type of product being sold, prevent the identification of variable insurance products as mutual funds or short-term assets, and require the description of

possible penalties or tax consequences from redemption or surrender. The proposed rule also provides for product standards of risk and reward classification and a presentation of hypothetical rates of return to customers to ensure that they understand the effect a down market can have on their investment.

Despite the cost of compliance, many in the industry support the proposed rule, feeling that it will help enhance consumer comfort with variable annuity purchases by reducing improper sales practices. The rule represents a compilation of informal guidance from FINRA. The deadline for comments on the proposed rule is September 30.

Additional Information

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