Financial Services Regulatory Highlights

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Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability and Transparency

On October 3, 2008, the Emergency Economic Stabilization Act was signed into law. The Act established the Office of Financial Stability (OFS) within the Department of the Treasury (Treasury) and authorized the Troubled Asset Relief Program (TARP).

Every 60 days, the U.S. Comptroller General is required to report on a variety of areas associated with oversight of TARP. In addition, the GAO plans to continue to monitor the program and other issues including future and ongoing capital purchases, other transactions undertaken as part of TARP (e.g., capital purchases in Citigroup and American International Group), and the status of other aspects of TARP.

Through the Capital Purchase Program (CPP)--a preferred stock and warrant purchase program--Treasury provided more than $150 billion in capital to 52 institutions as of November 25, 2008. Although the GAO recognizes that TARP has existed for less than 60 days, Treasury has yet to address a number of critical issues, including determining how it will ensure that CPP is achieving its intended goals and monitoring compliance with limitations on executive compensation and dividend payments. Moreover, further actions are needed to formalize transition-planning efforts and establish an effective management structure and an essential system of internal control.

To help ensure the program's integrity, accountability, and transparency, GAO recommends that Treasury:

- Work with the bank regulators to establish a systematic means of determining and reporting in a timely manner whether financial institutions' activities are generally consistent with the purposes of CPP and help ensure an appropriate level of accountability and transparency;
- Develop a means to ensure that institutions participating in CPP comply with key program requirements (e.g., executive compensation, dividend payments, and the repurchase of stock);
- Formalize the existing communication strategy to ensure that external stakeholders, including Congress, are informed about the program's current strategy and activities and understand the rationale for changes in this strategy to avoid information gaps and surprises;
- Facilitate a smooth transition to the new administration by building on and formalizing on-going activities, including ensuring that key OFS leadership positions are filled during and after the transition;
- Expedite OFS' hiring efforts to ensure that Treasury has the personnel needed to carry out and oversee TARP;
- Ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for Contracts priced on a time and materials basis, and move toward fixed-price arrangements whenever possible;
- Continue to develop a comprehensive system of internal controls over TARP, including policies, procedures, and guidance that are robust enough to protect taxpayers' interests and ensure that the program objectives are being met;
- Issue final regulations on conflicts of interest quickly and review and renegotiate mitigation plans to enhance specificity and compliance; and
- Institute a system to effectively manage and monitor the mitigation of conflicts of interest.

For additional information, refer to the full report by the GAO available at
http://www.gao.gov/new.items/d09161.pdf

Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages

On December 4, 2008, the Government Accountability Office (GAO) released its second oversight report on Treasury's implementation of the Troubled Asset Relief Program (TARP).

The report looked specifically at the efforts to address defaults and foreclosures in home mortgages. The GAO recommended that the Office of Financial Stability (OFS) work with banking regulators to monitor how financial institutions will utilize capital injections from TARP funds to preserve homeownership. GAO noted that every state experienced at least a 10 percent increase in foreclosures between 2005 and the second quarter of 2008. In addition, 23 states have experienced 100 percent or more increases in foreclosures. OFS initially intended to purchase troubled mortgages and mortgage-related assets, use its ownership position to influence loan servicers, and achieve more aggressive mortgage modification standards. However, within two weeks of the Emergency Economic Stabilization Act (EESA), Treasury determined it needed to move more quickly to stabilize financial markets and announced it would use $250 billion of TARP funds to inject capital directly into qualified financial institutions by purchasing equity. GAO said OFS has established an Office of Homeownership Preservation, but the office has not yet issued a strategy for preserving homeownership.

Federal Reserve Announces Extension of Three Liquidity Facilities Through 4/30/09

On December 2, 2008, the Federal Reserve announced the extension through April 30, 2009, of three liquidity facilities: (1) the Primary Dealer Credit Facility (PDCF); (2) the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF); and, (3) the Term Securities Lending Facility (TSLF). These facilities were previously authorized through January 30, 2009. With the extension, the above facilities will now be consistent with other liquidity-related facilities such as the Commercial Paper Funding Facility (CPFF) and the Money Market Investor Funding Facility (MMIFF).

As a brief overview of the above liquidity-related facilities, the PDCF provides discount window loans to primary dealers. The AMLF provides loans to depository institutions to purchase asset-backed commercial paper from money market mutual funds. Under the TSLF, the Federal Reserve Bank of New York auctions term loans of Treasury securities to primary dealers. The CPFF provides liquidity backstop to U.S. issuers of commercial paper. Finally, the MMIFF supports a private-sector initiative to provide liquidity to U.S. money market investors.

Agencies Approve Final Rule on Deduction of Goodwill from Tier 1 Capital

On December 16, 2008, the FRB, FDIC, OCC, and OTS approved the final rule that will permit banking organizations to reduce the amount of goodwill they must deduct from tier 1 capital by any associated deferred tax liability. Banking organizations may elect to apply this final rule for purposes of the regulatory reporting period ending December 31, 2008.

Banking organizations that elect to apply the final rule will be allowed to reduce the amount of goodwill by the amount of any deferred tax liability associated with that goodwill. The amount of deferred tax liability that can be deducted must reflect the maximum exposure to loss in the event that such goodwill is impaired or derecognized for financial reporting purposes. If deducted from goodwill, banks cannot net the deferred tax liability against deferred tax assets when determining regulatory capital limitations on deferred tax assets. The Agencies are updating regulatory guidance to reflect the provisions of this final rule.

OCC Conditionally Approves First National Bank "Shelf Charter" to Expand Pool of Qualified Bidders for Troubled Institutions

On November 21, 2008, the Office of the Comptroller of the Currency (OCC) announced conditional approval of a national bank "shelf-charter." This preliminary approval allows a national bank charter to remain inactive until an investor group is ready to acquire troubled assets through the Federal Deposit Insurance Corporation's bid process. The first approval was granted to establish the Ford Group Bank National Association.

The process begins with an OCC review of the proposed management team, the sources and amount of capital, which would be used to acquire and maintain the bank, as well as a business plan that outlines the acquired bank's operations. Following this evaluation the OCC can grant preliminary approval of a national bank charter subject to further requirements such as detailed operating plans and OCC oversight.

FDIC deposit insurance can be approved in addition to the shelf-charter if both entities approve the measures.

However, if a bid is not accepted by the FDIC, the charter remains on the shelf for up to 18 months and can be used for other bids.

OCC Announces Revised Examination Procedures for Regulation DD

On November 19, 2008, The Office of the Comptroller of the Currency (OCC) issued bulletin OCC 2008-33 to announce its revisions of interagency consumer compliance examination procedures for Regulation DD (12 CFR 230). Regulation DD implements the Truth in Savings Act.

The revised procedures include changes made to Regulation DD that simplify and clarify requirements regarding e-communication and the Electronic Signatures in Global and National Commerce Act (E-Sign Act). The E-Sign Act does not mandate that institutions or consumers use or accept electronic records or signatures. However, it does permit institutions to satisfy requirements that information, such as Regulation DD disclosures, be provided in writing to a consumer by providing the information electronically after obtaining the consumer's affirmative consent. The procedures also contain specific discussion about, and examination steps to assess, whether banks provide consumers disclosure information as required by Regulation DD.

OCC Bulletin 2008-33 replaces and rescinds OCC Bulletin 2007-41, which released a prior version of the examination procedures.

FDIC Publication Helps Consumers Understand Higher Deposit Insurance Coverage

On December 4, 2008, the FDIC published a special edition of the agency's FDIC Consumer News entitled "Your New, Higher FDIC Insurance Coverage: How You Can Be Fully Protected." Among the key points made in the publication:

- The basic limit on federal deposit insurance coverage was temporarily increased from at least $100,000 to at least $250,000 per depositor. However, as always, a depositor may qualify for more than the basic insurance coverage at one insured bank because the FDIC provides separate insurance coverage for deposits held in different "ownership categories," such as single and joint accounts.
- By law, the basic FDIC insurance limit will return to $100,000 on January 1, 2010. That means all the deposits a consumer has at a bank in his or her name alone will be fully insured up to $250,000 through December 31, 2009. After that date, the depositor will only be insured up to $100,000, with any balance over that limit becoming uninsured. The reduction in coverage starting in 2010 will not affect certain retirement accounts, which will continue to be protected up to $250,000.
- The FDIC has eased the rule governing "revocable trust accounts" that pass to named beneficiaries when the account owner dies. No longer does the FDIC consider only the account owner's spouse, child, grandchild, parent or sibling as "qualifying

beneficiaries" for additional insurance coverage ($250,000 if there is one beneficiary, $500,000 if there are two, and so on). As a result of the change, an account owner can name any person or charity as a beneficiary and the owner will qualify for the additional deposit insurance coverage.

- Through year-end 2009, certain checking accounts at participating banks will be fully insured by the FDIC, no matter how much money is in them. This special insurance coverage applies only to no-interest checking accounts and certain other low-interest transaction accounts, and only at participating institutions.

The OCC and Wachovia Entered Amended Settlement Agreement to Reimburse Consumers Directly

On December 11, 2008, the Office of the Comptroller of the Currency (OCC) entered into an amended settlement agreement with Wachovia Bank, National Association directing the bank to issue checks to consumers that may have been harmed by payment processors for telemarketers that had account relationships with Wachovia. As a result of the OCC's action, the bank will issue checks totaling over $150 million to more than 740,000 consumers. Checks were mailed on December 11.

This revised reimbursement process assured that consumers received restitution reimbursement checks. The payment processors and telemarketers involved were Payment Processing Center, LLC, FTN Promotions, Inc. dba Suntasia, Inc., Netchex Corp., and Your Money Access LLC, and related companies.

The practices cited by the OCC in the settlement involved the use of remotely created checks, or RCCs, by payment processors for telemarketers that maintained account relationships with the bank. An RCC is a check that is not created by the accountholder and does not bear the accountholder's signature. Instead, the signature block of the check includes text such as "authorized by your depositor, no signature required."

The telemarketers obtained bank account information over the phone by offering consumers a range of questionable products and services. With the account information obtained during the call, the telemarketer would direct the payment processor to create a remotely created check. The payment processor would then deposit the remotely created check into the processor's account at Wachovia, and funds were then withdrawn from consumers' accounts to make payment on the check and deposited into the processor's account. A large percentage of these RCCs were returned to Wachovia by individuals, or their financial institutions, who said the checks were never authorized or that they had never received the products or services offered by the telemarketers.

The checks from Wachovia were mailed to consumers by the United States Court Settlement Administrator. They are legitimate and should be cashed or deposited. As a result of the bank's settlement of a related class action lawsuit, the mailing also contained a process for consumers to request further reimbursement if customers believe they have been charged for bank fees that would not have been charged had the transactions in question not occurred.

FinCEN: BSA Electronic Filing Requirement

In an effort to make Bank Secrecy Act (BSA) filing requirements more secure and efficient, the Financial Crimes Enforcement Network (FinCEN) announced in July its plan to retire the BSA Magnetic Media Filing Program and transition to a web-based electronic filing system known as BSA E-Filing. Current Magnetic Media filers are required to switch to the BSA E-Filing system no later than December 31, 2008. Magnetic media submissions received after the deadline will be considered an indicator of non-compliance. The new web-based BSA E-Filing application does not require storage media, such as tapes and diskettes and it will reduce the time it takes to file a wide range of BSA forms. Filers may access details on registration and receive an overview of the BSA E-Filing at http://bsaefiling.fincen.treas.gov/.

FinCEN Announces Final Rule on Currency Transaction Reporting Exemptions

On December 4, 2008, FinCEN, in accordance with recommendations from the Government Accountability Office (GAO), announced submission of its final rule to simplify currency transaction reporting exemptions to eligible clients. The Bank Secrecy Act allows depository institutions to exempt certain classes of customers from the requirement to report currency transactions in excess of $10,000.

The following updates will be made to currency transaction reporting requirements:

- No annual review or designation of exempted person required for customers who are other depository institutions, U.S. or State governments, or entities acting with governmental authority.
- Otherwise, eligible non-listed companies or payroll customers can be designated after either two months time (previously twelve months) or following a risk-based analysis of customer transactions.
- FinCEN's guidance on the definition of "frequent" transactions will be changed from eight to five transactions per year.
- A biennial renewal of the designation of exempt persons filing for otherwise eligible Phase II customers is no longer required. However, an annual review must be conducted.
- Depository institutions will no longer be required to record and report change of control in designated non-listed or payroll customers.

FDIC Issues Final Rule on Recordkeeping Requirements for QFCS

On December 16, 2008, The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) issued a final rule to improve the FDIC's ability to monitor and evaluate risks in certain insured depository institutions with qualified financial contracts (QFCs), as well as assure preparedness if such institutions fail.

The recordkeeping requirements in the final rule will require insured depository institutions, defined as troubled, to provide certain crucial information to the FDIC in a timely manner, including adequate position level documentation of the counterparty relationships of failed institutions. This information is critical to the

FDIC's ability to monitor risks in such institutions and meet its statutory obligations regarding the treatment of QFCs in the event of its appointment as receiver of a failed insured depository institution. Under this statutory framework, the final rule further improves the FDIC's ability to facilitate an orderly resolution of QFCs and insured institutions in a manner that is least costly to the deposit insurance fund and limits the potential for uncertainty and disruption in the financial markets.

The final rule requires an institution in troubled condition, upon written notification by the institution's appropriate federal banking agency or the FDIC, to produce (1) certain position level and counterparty level data; and (2) certain QFC counterparty and portfolio identifiers, in addition to other QFC-related information. This information must be made available to the FDIC immediately at the close of processing of the institution's business day for a period provided in the notification. A de minimus exception is included in the final rule, which provides an exemption to institutions with a small number of QFCs from the mandatory electronic files requirements that apply to other institutions.

Mortgage Lender Agrees to Settle FTC Charges That It Charged African Americans and Hispanics Higher Prices for Loans

On December 16, 2008, a home mortgage lender, Gateway Funding Diversified Mortgage Services, L.P., agreed to settle Federal Trade Commission (FTC) allegations that it violated the Equal Credit Opportunity Act (ECOA) by charging African Americans and Hispanic consumers higher prices for mortgage loans than non-Hispanic white consumers.

The ECOA and its implementing Regulation B prohibits creditors from discriminating against applicants for credit on the basis of race, color, religion, sex, marital status, age, etc. The commission alleges that the defendant allowed loan officers to charge discretionary overages resulting in African-Americans and Hispanics being charged higher prices because of their race or ethnicity. According to the complaint, the price disparities are substantial and cannot be explained by factors related to underwriting risk or credit characteristics of the applicants. The proposed settlement prohibits the defendants from discriminatory lending practices and requires them to implement the following programs: (1) a fair lending training program, (2) a data integrity lending program designed to ensure accuracy and completeness of loan data, and (3) a fair lending monitoring program that includes a system for performing periodic analyses to monitor for disparities in loan prices.

Federal Reserve Seeks Public Comment on Proposed Changes to Regulation Z

On Friday December 5, the Federal Reserve Board proposed for public comment changes to Regulation Z (Truth in Lending) that would revise the disclosure requirements for mortgage loans. The revisions would implement the Mortgage Disclosure Improvement Act (MDIA), which was enacted in July 2008 as an amendment to the Truth in Lending Act (TILA).

The MDIA requires creditors to give good faith estimates of mortgage loan costs ("early disclosures") within three business days after receiving a consumer's application for a mortgage loan and before any fees are collected from the consumer, other than a reasonable fee for obtaining the consumer's credit history. These requirements are consistent with the Board's July 2008 final rule, which applied to loans secured by a consumer's principal dwelling. The MDIA broadens this requirement by also requiring early disclosures for loans secured by dwellings other than the consumer’s principal dwelling, such as a second home.

In addition, the proposed rules would implement the MDIA's requirements that:

- Creditors wait seven business days after they provide the early disclosures before closing the loan; and

- Creditors provide new disclosures with a revised annual percentage rate (APR), and wait an additional three days before closing the loan, if a change occurs that makes the APR in the early disclosures inaccurate beyond a specified tolerance.

The proposed rules would permit a consumer to expedite the closing to address a personal financial emergency, such as a foreclosure. Under the MDIA, the proposed rules would become effective on July 30, 2009.

SEC Approves Measures to Strengthen Oversight of Credit Rating Agencies

On December 3, 2008, the Securities and Exchange Commission (SEC) approved a series of measures to increase transparency and accountability at credit rating agencies and to ensure that firms provide more meaningful ratings and greater disclosure to investors.

The new measures impose additional requirements on credit rating agencies, whose ratings of residential mortgage-backed securities backed by subprime mortgage loans and of collateralized debt obligations linked to subprime loans contributed to the recent turmoil in the credit markets. The SEC also proposed additional measures related to transparency and competition concerning credit rating agencies. The SEC's actions were informed by the agency's extensive 10-month examination of three major credit rating agencies that found significant weaknesses in ratings practices.

This is the second set of credit rating agency reforms since the SEC received its new regulatory authority from Congress to register and oversee credit rating agencies. The initial rules were implemented by the Commission under the Credit Rating Agency Reform Act in June 2007. The regulatory program established through the Credit Rating Agency Reform Act allows the SEC to promulgate rules regarding the public disclosure, recordkeeping and financial reporting and substantive requirements to ensure that credit rating agencies conduct their activities with integrity and impartiality.

The following rules are meant to supplement previous rules implemented by the Commission under the Credit Rating Agency Reform Act in June 2007:

- Final Amendments to the instructions to Exhibits 1 and 2 on Form NRSRO;

- Records of Rating Actions (Final Amendments to Rule 17g-2(a)(8) and instructions to Exhibit 1 on Form NRSRO);

- Final Amendments to Rule 17g-2;

- Final Amendments to Rule 17g-3;

- Final Amendments to Rule 17g-5(c);

- Proposed Amendments to rule 17g-2; and

- Re-proposed Amendments to Rule 17g-5.

SEC Moves to Regulate Some Equity Indexed Annuities

On Wednesday December 17, 2008, the Securities and Exchange Commission (SEC) voted to begin scrutinizing annuities linked to equity indexes. The SEC has agreed to define annuity contracts and optional annuity contracts as securities in order to better monitor this ever-growing $120 billion market. By defining the products as securities, equity linked annuities will be subject to the federal Securities Act and will have to be registered with the SEC and cannot be sold to inappropriate investors. Opponents of the SEC action include insurance agents and some lawmakers, who say it will create unnecessary regulations, reduce choices and increase costs for consumers. However, the SEC and state regulators worry that these products are being sold to elderly investors, despite the long accumulation periods. Equity linked annuities also have higher surrender charges, making it difficult for investors to pull out if they need money. The SEC Chairman, Christopher Cox, says that this action will help protect seniors and other investors from fraudulent practices that can occur in the sale of equity-indexed annuities.

SEC Finalizes ARS Settlements with Citigroup and UBS, Providing Nearly $30 Billion in Liquidity to Investors

On December 11, 2008, the Securities and Exchange Commission (SEC) finalized settlements with Citigroup Global Markets, Inc. (Citi) and UBS Securities LLC and UBS Financial Services, Inc. (UBS) that will provide nearly $30 billion to tens of thousands of customers who invested in auction rate securities before the market for those securities froze in February.

The settlements resolve the SEC's charges that both firms misled investors regarding the liquidity risks associated with auction rate securities (ARS) that they underwrote, marketed and sold. According to the SEC's complaints, filed in federal court in New York City, Citi and UBS misrepresented to customers that ARS were safe, highly liquid investments that were comparable to money markets. According to the complaints, in late 2007 and early 2008, the firms knew that the ARS market was deteriorating, causing the firms to have to purchase additional inventory to prevent failed auctions.

Linda Chatman Thomsen, Director of the SEC's Division of Enforcement, said, "The SEC will continue to aggressively investigate whether other broker-dealers and individuals have failed to disclose to investors material risks about ARS that they marketed and sold. We also look forward to finalizing the four other settlements-in-principle that the Division has entered into with Bank of America, RBC Capital Markets, Merrill Lynch and Wachovia."

Without admitting or denying the SEC's allegations, Citi and UBS agreed to be permanently enjoined from violations of the broker-dealer fraud provisions and to comply with a number of undertakings. Both firms also face the prospect of financial penalties to the Commission based on the traditional factors the Commission considers for penalties and based on whether the individual firm has fulfilled its obligations under its settlement agreement.

For additional information, refer to
http://www.sec.gov/news/press/2008/2008-290.htm

Former Fidelity Employees to Pay More than $1 Million to Settle SEC Charges for Improperly Accepting Lavish Gifts Paid for by Brokers

On December 11, 2008, The Securities and Exchange Commission (SEC) announced settlements of an enforcement action against eight former employees of Fidelity Investments' equity trading desk. Collectively, the eight employees will pay more than $1 million to settle SEC charges for improperly accepting lavish gifts paid for by outside brokers courting business from Fidelity. The SEC charges find that the eight former employees violated federal securities laws, section 17 (e) (1) of the Investment Company Act and section 206 (2) of the Investment Advisers Act, by accepting prohibited compensation from brokers including among them private jet trips, lodging and premium sports tickets. In addition, the SEC found the former vice president and head of the trading desk a cause of Fidelity's failures to seek best execution for its clients and to disclose conflicts of interest to its clients, as well as failed to supervise the traders. The respondents have consented to the charges without admitting or denying the Commission's findings, and will pay disgorgement, prejudgment interest and applicable penalties.

SEC Issues Open Letter to CEOs of Registered Firms on the Importance of Compliance Programs

On December 2, 2008, the SEC's Office of Compliance Inspections and Examinations issued a letter to CEOs stressing the importance of maintaining an adequate compliance program and function, especially during the current economic crisis. The letter follows comments made by SEC Chairman Christopher Cox at the annual CCOutreach National Seminar where he stressed that the compliance function is critical to reducing the markets uncertainty about a company's operations, increasing the confidence of its counterparties, and protecting its investors.

During uncertain financial conditions, firms may be looking to cut expenses by reducing compliance related costs. The SEC makes it clear that cut backs in compliance usually leads to violations and when such violations are discovered, the SEC will not grant favor to those companies who chose to make a cost-cutting decision.

NAIC Adopts Reinsurance Modernization Proposal

On December 7, 2008, the National Association of Insurance Commissioners (NAIC) announced that it has adopted its Reinsurance Regulatory Modernization Framework Proposal, which aims to modernize the U.S. state-based regulation of reinsurance.

The proposal creates two new classes of reinsurers in the United States: U.S.-domiciled national reinsurers and non U.S.-based port of entry (POE) reinsurers, and introduces modified collateral requirements for eligible reinsurers. The proposal also establishes a new framework for state-based reinsurance regulation based on the concepts of supervisory recognition, single-state licensure for U.S. reinsurers and single-state certification for non-U.S. reinsurers from approved jurisdictions.

The proposal also creates the NAIC Reinsurance Supervision Review Department (RSRD), which will evaluate the reinsurance supervisory regimes of other countries and establish standards for a state to be certified to regulate reinsurance on a cross-border basis. In order to be certified as a POE reinsurer, a reinsurer must be licensed by a non-U.S. jurisdiction recommended as eligible for recognition by the RSRD. The current NAIC Credit for Reinsurance Model Act would remain in place for reinsurers that do not choose to become either national or POE reinsurers.

These efforts represent a conceptual framework only. The NAIC will next have to draft model legislation based on this framework, and then each state will have to work to pass similar legislation in its respective legislature, before the modernization efforts can take effect.

Additional Information

If you would like additional information about the topics discussed in this newsletter, or about PwC Financial Services Regulatory, please call:

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