

Financial Services Regulatory Highlights

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PwC Announces the Release of the 2007-2008 Edition of A Regulatory Guide for Foreign Banks in the United States

PricewaterhouseCoopers is pleased to release its 2007–2008 edition of **A regulatory guide for foreign banks in the United States (Guide)**. We intend for the Guide to serve several purposes:

Be an introduction to US regulation and supervision for foreign banks and their senior management new to the US market. The Guide describes the many forms of business organization available to foreign banks, the regulators of these operations and, when necessary, how an institution obtains a license or approval to begin operations.

Be a source for highlighting the many complex issues that foreign banks must navigate in doing business here to ensure they meet regulatory expectations. The Guide describes in some detail how foreign bank operations in the United States are supervised and examined and some of the key regulatory and supervisory issues they face in conducting their business, such as anti-money laundering regulations.

Be an opportunity for us to bring you PwC's insights on trends shaping the banking industry in the United States and the growing and diverse roles of foreign banks in that industry. As an integral part of the US banking system, foreign banks are always dealing with new opportunities, new risks and challenges and new market developments.

Since publication of the last guide in 2005, we have noted an uptick in new entrants to the US market, greater attempts to harmonize supervisory and enforcement policies in anti-money laundering and in countering the financing of terrorism, and additional refinements in regulatory policy, such as with respect to foreign bank branch asset pledge requirements.

To see The Guide in its entirety, go to
<http://www.pwc.com/extweb/pwcpublications.nsf/docid/CB7F1D33087BBAE2852570B5005E1D17>

House and Senate Committee Chairmen Discuss Their Financial Services Legislative Priorities For 2008

[In two separate press briefings, Senate Banking Committee Chairman Chris Dodd and House Financial Services Committee Chairman Barney Frank outlined their legislative priorities for 2008.](#)

At a press briefing on January 23, 2008, Chairman Chris Dodd (D-CT) of the Senate Banking Committee reviewed a number of priorities for his Committee in 2008. Among the financial services topics highlighted by the Chairman were enactment of FHA reform legislation as soon as possible, action on mortgage lending reform, homelessness prevention, regulation of industrial loan corporations, credit card marketing and billing practices, comprehensive Flood Insurance reform, proposals to reform and improve insurance regulation – including surplus lines regulation and an Optional Federal Charter -- and in the area of securities, issues concerning executive compensation, proxy access, hedge fund regulation, and accounting and regulatory issues surrounding the increasing globalization of securities markets.

At a press briefing on January 24, 2008, Chairman Barney Frank (D-Mass) of the House Financial Services Committee indicated that the mortgage market and lending practices will be on the top of the Committee's agenda in 2008, Frank said regulations did not keep up with mortgage market innovations and need reform through such means as restricting certain types of loans or imposing new regulatory requirements. The Chairman also promised credit card reform and the updating of the Community Reinvestment Act and Home Mortgage Disclosure Act. Other issues he said would be a priority for the Committee included: preserving affordable housing, examining debt relief options for highly indebted countries, examining appraisal practices, reforming suspicious activity reporting and exploring a federal charter for insurance.

FinCEN Issues Ruling on Reporting of Certain Currency Transactions for Sole Proprietorships and Legal Entities Operating Under a "Doing Business As" Name

[On January 25, 2008, the Financial Crimes Enforcement Network \(FinCEN\) issued a ruling to clarify the currency transaction report \(CTR\) filing obligations when reporting transactions involving sole proprietorships and legal entities operating under a "doing business as" \(DBA\) name.](#)

A sole proprietorship is a business in which one person, operating in his or her own personal capacity, owns all the assets and owes all the liabilities. When filing a CTR involving a sole proprietorship, financial institutions are required to complete one section 'A', containing the name of the sole proprietorship's owner, the sole proprietorship's DBA name, the owner's social security number (SSN), home address, date of birth, and occupation. Only one

section 'A' is required, even if the business operations have a different address and/or tax identification number (TIN) than its owner.

In order to accommodate financial institutions who wish to file in accordance with FIN- 2006-R003, 8 FinCEN will continue to accept CTR's completed with two section 'A's when the transactions involve a sole proprietorship. FIN-2006-R003 stated that, when filing a CTR, financial institutions should provide information on both the sole proprietorship and its owner. Because the CTR form does not accommodate

for both sets of information in a single section 'A', FIN-2006-R003 stated that financial institutions should file two section 'A's containing this information. An institution would check the "multiple persons" box, even though a sole proprietorship is not a separate person from its operator, to indicate that two section 'A's were being completed. The present ruling similarly applies to CTR's filed on legal entities operating under a DBA name. Whether the entity's and DBA's address and/or employer identification number (EIN) are the same or different, when filing a CTR on a legal entity operating

under a DBA name, financial institutions are required to complete one section 'A' containing the name of the entity, the DBA name, the entity's EIN, the entity's address, and the entity's business activity. However, to maintain consistency within the present ruling, we will accept two section 'A's when filing a CTR on a legal entity operating under a DBA name.

Federal Reserve Issues Guidance on Confidentiality Provisions in Third Party Agreements

[In a recent Supervisory Letter \(07-19\), the Banking Supervision and Regulation Division of the Federal Reserve Board reinforced its expectations regarding confidentiality provisions in agreements between a banking organization and its counterparties \(for example, mutual funds, hedge funds, and other trading counterparties\) or other third parties.](#)

The letter states that it is contrary to Federal Reserve regulation and policy for agreements to contain confidentiality provisions that (1) restrict the banking organization from providing information to Federal Reserve supervisory staff; (2) require or permit, without the prior approval of the Federal Reserve, the banking organization to disclose to a counterparty that any information will be or was provided to Federal Reserve supervisory staff; or (3) require or permit, without the prior approval of the Federal Reserve, the banking organization to inform a counterparty of a current or upcoming Federal Reserve examination or any nonpublic Federal Reserve supervisory initiative or action. Banking organizations that have entered into agreements containing such confidentiality provisions are subject to legal risk.

Some agreements between banking organizations and counterparties contain confidentiality provisions that allow the banking organization to provide supervisory staff access to the agreement and related information provided by the counterparty and relieve the organization of any obligation to inform the counterparty

when the banking organization is asked to furnish such information to supervisory staff. For example, the Global Documentation Steering Committee (GDSC) published standard confidentiality terms to promote prompt negotiation of confidentiality agreements. The GDSC Confidentiality Terms (2004) contain a provision stating that in the event that a supervisory authority with appropriate jurisdiction requests access to or delivery of confidential information from an organization, the organization may comply with such request and should give its counterparty written notice of such request only "if lawfully permitted to do so." Given that banking organizations are not permitted without prior approval from the Federal Reserve to inform their counterparties that Federal Reserve staff is reviewing, has reviewed, or has asked to review information covered by an agreement, the GDSC Confidentiality Terms are consistent with regulatory requirements for banking organizations entering into third-party agreements that contain confidentiality provisions.

Agencies Extend Exam Cycle for Larger Community Banks

[The Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, and Office of Thrift](#)

[Supervision \(collectively, the Agencies\) jointly adopted as final the interim rules issued on April](#)

10, 2007, that implemented section 605 of the Financial Services Regulatory Relief Act of 2006 (FSRRA) and related legislation (collectively the Examination Amendments).

The Examination Amendments permit insured depository institutions (institutions) that have up to \$500 million in total assets, and that meet certain other criteria, to qualify for an 18-month (rather than 12-month) onsite examination cycle. Prior to enactment of FSRRA, only institutions with less than \$250 million in total assets were eligible for an 18-month onsite examination cycle. The interim rules made parallel changes to the Agencies' regulations governing

the onsite examination cycle for U.S. branches and agencies of foreign banks (foreign bank offices), consistent with the International Banking Act of 1978 (IBA). In addition to implementing the changes in the Examination Amendments, the interim rules clarified when a small insured depository institution is considered "well managed" for purposes of qualifying for an 18-month examination cycle.

FTC Issues Annual Report on Enforcement Activities for Nonbank Sector

The Federal Trade Commission (FTC) is charged with enforcement of the Federal Trade Commission Act and various consumer financial laws and regulations, including the Truth-in-Lending Act (TILA), Consumer Leasing Act (CLA), Equal Credit Opportunity Act (ECOA) and Electronic Funds Transfer Act (EFTA) with respect to most nonbank entities in the United States.

The FTC reported that during the summer of 2007, its staff conducted a nationwide review of home mortgage advertisements that focused on claims for very low monthly payment amounts or interest rates, without adequate disclosures of other important loan terms. The review included advertisements currently appearing in Web sites, newspapers, magazines, direct mail, and unsolicited e-mail and faxes, including some advertisements in Spanish.

The FTC staff sent letters to more than 200 mortgage brokers and lenders, and media outlets that carried the advertisements, warning that some of the advertising claims may violate federal law. In the warning letters, the FTC advised the advertisers and media outlets that some mortgage ads are potentially deceptive or in violation of the TILA. Letters to advertisers advised them to review their ads, and to read business and consumer education materials on the FTC's Web site to learn about relevant laws and requirements. Letters to media outlets advised them about the potentially deceptive advertising, with guidance on screening ads for questionable claims. The FTC reported several ongoing nonpublic investigations of home mortgage advertisers for potential deceptive practices and violations of the TILA.

In 2007, the FTC also released a Bureau of Economics report presenting the results of a study on mortgage disclosures. The study examined how consumers search for mortgages, how well consumers understand mortgage cost disclosures and the terms of their loans, and whether better disclosures can help consumers understand mortgage costs, shop for mortgage loans, and avoid deceptive lending practices. The report presented the findings that mortgage disclosure forms fail to convey key mortgage costs and terms to many consumers. The study concluded that better disclosures can be created to help consumers understand the costs and terms of mortgages to enable them to make informed decisions about mortgage products.

The study's key findings also included that (1) with current disclosures, both prime and subprime borrowers misunderstood key loan terms, and both groups benefited from better disclosures; and (2) for complex loans, where prime and subprime borrowers had the most difficulty understanding loan terms, better disclosures provided the greatest benefit.

Based in part on the above mortgage disclosure study, the FTC submitted staff comments to the Federal banking agencies in response to the

agencies' request for comments on proposed illustrations of consumer information for subprime mortgage lending. In the comments, the FTC staff supported the agencies' efforts to develop mortgage disclosures to help subprime borrowers make better informed decisions. The FTC staff also recommended that the agencies consider testing the effectiveness of their proposed new disclosures and consider undertaking a more comprehensive effort to improve federal mortgage disclosures.

Although the FTC did not initiate any enforcement actions in 2007, the Commission stated in Congressional testimony in July 2007 that it is engaged in several ongoing, non-public fair lending investigations of mortgage lending companies. The testimony summarized how the Commission uses Home Mortgage Disclosure Act (HMDA) data as a screening or targeting tool for fair lending compliance investigations. According to the testimony, although some pricing data and loan applicant information are available, the HMDA data overall are limited and insufficient to establish a law

violation. Instead, the FTC uses the reported data to identify lenders with differences in outcomes for protected classes, and in particular for minorities compared to non-minorities. The testimony observed that, consequently, the principal goal of a fair lending investigation is to determine whether or not the differences in outcomes persist after legitimate underwriting criteria are taken into account, and that the FTC uses the HMDA data as a screening or targeting tool for fair lending compliance investigations. The testimony also noted that the FTC has a strong commitment to enforcing the fair lending laws and will pursue vigorously any violations revealed by its investigations.

The full report is on the FTC's website at www.ftc.gov.

FinCEN Issues Civil Money Penalty for Anti-Money Laundering Program Deficiencies

On January 28, 2008, FinCEN announced the assessment of a civil money penalty in the amount of \$12 million against Sigue Corporation and Sigue LLC (Sigue), a money services business. Concurrently, the Department of Justice announced today that Sigue has also entered into a deferred prosecution agreement on charges failing to maintain an effective anti-money laundering (AML) program and will forfeit \$15 million to the U.S. government. FinCEN's penalty will be deemed satisfactory by a portion of the \$15 million payment to the Department of Justice.

FinCEN determined that Sigue failed to establish and implement an AML program reasonably designed to ensure compliance with the Bank Secrecy Act which led, in turn, to a failure by management at Sigue to implement measures to respond to continued patterns of suspicious activity. Specifically, on multiple occasions over an extended period of time, 47 agents assisted customers in the structuring of transactions represented to be drug trafficking proceeds to avoid the currency transaction reporting requirements

of the Bank Secrecy Act. FinCEN found that Sigue's transaction monitoring system was not commensurate with the volume, dollar amounts and geographical reach of transactions processed by the money services business, resulting in the filing of incomplete and/or inaccurate suspicious activity reports. This occurred despite the repeated patterns of suspicious activity by the identical or similar customers, beneficiaries and agents. Sigue's failure to implement effective controls, training or independent testing to manage the risk of money laundering was serious, longstanding and systemic.

Sigue, without admitting or denying the allegations, consented to the civil money penalty.

Hedge Fund Working Group Issues Final Report and Standards

On January 22, the Hedge Fund Working Group (HFWG), a group made up of 14 UK-based hedge fund managers, published its final report, "Hedge Fund Standards." The report establishes voluntary "best practice" standards for hedge funds focusing on disclosure to investors and counterparties, valuation, risk management, fund governance and shareholder conduct. The final report follows the HFWG's draft report issued in October 2007.

With the issuance of its final report, the work of the HFWG is complete. The original 14 members have now become trustees of a Hedge Fund Standards Board (HFSB) which will maintain the

standards. The HFSB will also try to convince other hedge fund managers to join with the original 14 members in signing on to comply with the standards. The U.S. President's Working Group on Financial Markets continues to work to finalize similar standards for U.S. based hedge funds.

A copy of the report can be found at the HFWG website, <http://www.hfwg.co.uk>.

Director of SEC Office of Compliance Inspections and Examinations Discusses FAQ's about SEC Examinations

On January 17, 2008, Lori Richards, Director of the Office of Compliance and Inspections Examination at the SEC discusses FAQ's on SEC Examinations at the SIFMA Compliance and Legal Division January General Luncheon Meeting.

Ms. Richards discusses the following questions:

- Will my firm be examined?
- What issues are SEC examiners focused on now?
- If my firm is examined, what kind of information and documents are examiners likely to request?
- What are the possible outcomes of an SEC examination? and
- What can I do to ensure that the examination goes smoothly?

Will my firm be examined?

Ms. Richards states that the SEC uses the "language of principles" as the foundation for their work, "To best protect investors, examiners should focus on the areas where they may be at greatest risk of harm." The SEC focuses their attention on:

- Firms that are of such size, that, if anything went wrong, a significant number of investors would be affected; this is why we spend a fair amount of time examining large firms, and monitoring their compliance controls.
- Firms and areas within firms where compliance controls or supervision appears to be weak; these firms may have had a

prior exam or enforcement history indicating weak controls or problems, or present indications of compliance risk.

- Firms that are involved in activities that may present increased compliance risk, if not controlled adequately.

"Our risk-assessment process incorporates each of these approaches, and it helps guide examiners in every phase of examination --- which firms to examine, what areas to focus on, and what issues to look at."

What issues are SEC examiners focused on now?

Examiners are focusing on the firm's controls to value securities. They have put particular emphasis on:

- Whether the firm has controls and is implementing those controls when pricing structured products, illiquid securities or other difficult-to-price securities; and
- Whether processes and procedures related to risk management, valuation, accounting, and other back office functions are

adequate given the types of investments made.

Examiners want to understand the level of experience and sophistication of the personnel who are involved in pricing, and if there is some level of independence in the pricing process.

Review of controls to prevent insider trading in client, proprietary, or employee accounts is a high priority area in SEC examinations. The examiners will focus their attention on:

- Whether a firm has identified the source and type of non-public information that they and employees may be privy to; and
- Whether the firm has crafted and implemented adequate procedures to maintain the confidentiality of that information, and is using those procedures.

With regard to senior investors, examiners are focusing their attention on understanding the practices that firms are developing in the following areas:

- Marketing and advertising to seniors;
- Account opening;
- Product and account suitability;
- Ongoing review of the relationship and suitability of products;
- Discerning the changing needs of seniors;
- Surveillance and compliance reviews; and
- Training for firm employees.

What kind of information and documents are examiners likely to request?

Each SEC examination is tailored to the firm being examined, so it is not possible to have a one-size-fits-all document request. However, they are searching for ways to be more transparent in the kinds of documents and information being requested.

What are the possible outcomes of an examination?

Most SEC examinations end in a non-public deficiency letter -- which describes the deficiency and asks the firm for a response. On the other hand, in examinations where there are serious

deficiencies, examiners will refer the matter to enforcement staff. The following factors are used to determine if an enforcement action is necessary:

- Does it appear that fraud has occurred?
- Were investors harmed?
- If the conduct does not include fraud, is it serious?
- Did the firm apprise the SEC of the conduct and take meaningful corrective action?
- Is the conduct of a type/degree that is most appropriate for the SEC to handle, rather than another regulator?
- Is the activity in a particular area that the SEC wants to emphasize emerging types of wrongdoing?
- Did the actor profit from the conduct?
- Did the actor appear to act intentionally?
- Is the conduct recidivist in nature?
- Were the firm's supervisory procedures inadequate?

In 2007, 14% of exams of broker-dealers resulted in referrals to SEC enforcement staff for review.

What can compliance staff do to ensure the examination goes smoothly?

- Assume you will be examined.
- Don't run your compliance program around the regulatory exam process.
- Provide accurate, responsive information in a timely way.
- Talk with the exam team.

Remarks by the Director of FinCEN at the Anti-Money Laundering and Counter Terrorist Financing Conference

On December 5, 2007, James H. Fried, Jr., the Director of the FinCEN, spoke at the Anti-Money Laundering and Counter Terrorist Financing Conference. In his remarks, he addressed the following three areas:

- The role of the accountant as he or she serves a financial institution and the importance of the independent review within the context of our risk-based regulatory approach;
- A broader discussion of effectiveness and efficiency initiatives currently underway with respect to the financial industry; and
- Feedback on how the government uses the information reported under the Bank Secrecy Act ("BSA").

Role of Accountants in a Risk-Based Approach

The BSA requires financial institutions to establish AML programs that include an independent evaluation function to monitor the adequacy of the institution's internal program. The scope and frequency of this independent review should be commensurate with the risk of the financial services provided by, and customer base of, the respective institution.

Regulations require an independent review, not a formal audit by a certified public accountant or third party consultant. The review may be conducted by an officer, employee or group of employees, so long as the reviewer is not the designated compliance officer, does not report to the compliance officer, and has sufficient knowledge of the BSA and its regulations.

Regulatory Effectiveness and Efficiency Initiatives

Mr. Freis also discussed the efficiency and effectiveness proposals that FinCEN is currently working on. The first initiative focused on enhancing the risk-based approach to BSA examinations. FinCEN has been reaching out to study how different regulatory agencies are approaching risk scoping. Several meetings have taken place

with banking agencies and discussions have occurred with several State banking departments.

FinCEN is committed to being more risk-based in our regulatory approach going forward. The work that is performed by auditors and accountants transcends all sectors of the financial industry, so it is critical for us to understand the way risks are looked at and how independent reviews are conducted within the financial institutions so that FinCEN can improve their efforts to provide guidance to you on the risks.

The second initiative is how FinCEN can make it easier for distinct sectors of the financial industry to know all the regulations with which they may need to comply. FinCEN has begun to work on the creation of its own chapter in the CFR with one general part and separate parts for each industry.

BSA Data and How We Use It

The information that is provided in BSA data filed by financial institutions not only gives law enforcement, regulatory and intelligence agencies indicia of illicit activity, but it also provides data for identifying patterns, trends, vulnerabilities and compliance-related deficiencies, and for focusing on law enforcement resources. BSA information is used by law enforcement every day in regards to tips-offs, identifying information, trends, and deterrence.

FDIC Quarterly Review Looks at Subprime Loan Modification

In the current issue of FDIC Quarterly, released on January 10, 2008, the FDIC outlines the analytical case for a systematic and

streamlined loan modification process that will help avert foreclosure for borrowers who are

current on their loans, but who cannot refinance or afford the higher payments when interest rates reset.

The article – "**The Case for Loan Modification: With a Foreword by Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation**" – also addresses common misconceptions about a streamlined approach to subprime mortgage restructuring.

In another piece, "**Establishing Voluntary Excess Deposit Insurance: Results of the 2006 FDIC Study**," the authors report the results of a congressionally mandated study on the feasibility of establishing a voluntary deposit insurance system for deposits exceeding the maximum amount of FDIC insurance. The article describes market changes that have reduced the demand for excess deposit insurance and provided depositors with other

options to protect excess deposits. The authors also examine two possible approaches available to the FDIC if Congress were to decide the Corporation should play a role in providing excess deposit insurance.

This issue of the FDIC Quarterly also includes third quarter industry results from the Quarterly Banking Profile released on November 28, 2007. The FDIC Quarterly is available online at the FDIC's Web site at:

<http://www.fdic.gov/bank/analytical/quarterly/index.html>

New York Commission to Modernize the Regulation of Financial Services Considers Principles-Guided Regulation

On January 18, 2008, New York Governor Eliot Spitzer hosted the first formal meeting of the Commission to Modernize the Regulation of Financial Services (Commission), which includes heads of major financial services organizations, consumer advocates, the business community, legislators and regulators. The commission discussed an innovative proposal to institute principles-guided regulation in New York along with other potential reforms.

The Commission will make recommendations for new laws and regulations that promote competition and business growth, while effectively protecting consumers and honest businesses from unfair or unethical practices.

"Modernizing regulation of financial services is first and foremost about keeping New York the financial capital of the world," said Governor Spitzer. "The fact of the matter is that New York's current regulations are out of date. We must have regulations that promote our essential goals: a healthy, creative competitive market for financial services, access for consumers and businesses to the services they need, and strong, effective consumer protection. Furthermore, my experience has demonstrated to me that proper regulations will have a positive impact on the financial market. We have brought together many of the best minds in the State to accomplish this task."

The commission will consider:

- Developing "principles-guided" regulation as a unique alternative to the principles-based approach being instituted in the United Kingdom. The new method provides the benefits of a principles-based approach, while preserving the positive elements of current regulation. Under the principles-guided approach, the principles act as guidance for interpreting existing regulations and statutes, and as key objectives for developing any future regulation. The principles guide the regulator to focus on outcomes, rather than the rules in and of themselves.
- Having a single state regulator for all financial services. Similar products should not be treated differently if they are sold by different types of companies.
- Instituting a risk-based approach to regulation. Examinations of financial services companies should focus on what is important and what really makes a difference.
- Eliminating out-of-date rules that are unnecessarily burdensome.

- Insurance Superintendent Eric Dinallo, the Chair of the Commission, said: “The benefit of state regulation is that states can be the laboratory for developing best practices. We want to offer New York as a national model of how to regulate financial services.”

Richard. H. Neiman, Superintendent of Banks for New York State and a Price Waterhouse alumnus, said: “We see this as the perfect time to reevaluate our regulatory models, to ensure they are calibrated to respond to the emerging challenges of an increasingly global marketplace. The Banking Department is well underway with a top-to-bottom review of the banking law, to identify further opportunities to reform.”

Commission Executive Director Scott Rothstein said: “We are proposing that the commission consider recommending a unique approach to regulation in New York--a principles-guided regime. This is a way to focus on outcomes within the existing regulatory framework. The principles serve to help the interpretation of rules and guide creation of new rules. We can thus move to greater focus

on outcomes, without sacrificing certainty for the industry or consumer protection.”

Hector Sants, the Chief Executive Officer of the Financial Services Authority of the United Kingdom, spoke to the commission about how his agency, the sole regulator for all financial services in the U.K., is transitioning from rules-based to principles-based regulation.

The work of the commission will be conducted through working groups by industry: insurance, banking and securities, and by topics such as principles-guided regulation, a single state regulator, registration and licensing, and how to manage the difference between regulation required for transactions with individual investors as opposed to among large institutions.

President Signs Terror Backstop Extension

[On December 26, 2007, President George W. Bush signed into law legislation extending the federal terrorism insurance backstop for an additional seven years. The Terrorism Risk Insurance Program Reauthorization Act \(TRIPRA\) of 2007 \(H.R. 2761\) was approved by the Senate in November and by the House of Representatives on December 18.](#)

TRIPRA extends the existing backstop program for seven years, modifying the definition of terrorism to include domestic acts of terror. It also includes a mandate for two studies by the U.S. General Accountability Office (GAO). One study will address the issue of providing terrorist insurance coverage for nuclear,

biological, chemical and/or radiological events. The second will examine high-risk areas in the United States that are faced with unique capacity constraints.

TRIPRA is an extension of the 2005 Terrorism Risk Insurance Extension Act, which was due to sunset at year’s end. Had it expired, businesses may have experienced difficulty obtaining terrorism coverage that lending institutions often require as a condition of real estate financing.

FINRA Issues Fine for Procedural Failures Regarding Soft Dollar Payments and Distributing Hedge Fund Sales Materials

[On January 9, 2008, FINRA issued a fine to SMH Capital Inc. for failing to adopt adequate supervisory procedures and systems designed to address its prime brokerage and soft dollar services to hedge funds.](#)

- Drafting and distributing hedge fund sales materials that did not adequately disclose material investment risks to potential hedge fund investors;

The firm's failures including:

- Engaging in an improper compensation agreement with two SMH brokers who also managed hedge funds;
- Failing to have policies and procedures to police its soft dollar payments -- SMH sent two improper soft dollar payments totaling \$325,000 to a hedge fund manager;
- Distributing sales materials that failed to disclose the risks inherent in hedge fund investing; and
- Failure to retain and preserve certain e-mails and instant messages of firm employees between January 2003 and December 2004.

In settling this matter, SMH Capital Inc. neither admitted nor denied the charges, but consented to the entry of FINRA's findings.

Additional Information

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

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