Financial Services Regulatory Highlights

August 2011

Banking Agencies

Banking Agencies Issue Regulatory Guidance on Treatment of Federal Debt

On August 5, in response to Standard & Poor's downgrade of the U.S. government's and federal agencies' long-term debt rating from AAA to AA+ the federal banking supervisory agencies (Federal Reserve Board, Federal Deposit Insurance Corporation, National Credit Union Administration and Office of the Comptroller of the Currency)) issued guidance to clarify the treatment of federal debt for regulatory purposes. The guidance provides that for risk-based capital purposes, the risk weights for Treasury securities and other securities issued or guaranteed by the U.S. government, government agencies, and government-sponsored entities will not change. The treatment of Treasury securities and other securities issued or guaranteed by the U.S. government, government agencies, and government-sponsored entities under other federal banking agency regulations, including, for example, the Federal Reserve Board's Regulation W, will also be unaffected.

Federal Reserve Board Issues Guidance to Clarify Provisions of Regulation CC and Repeal of Regulation Q

On August 15, the Federal Reserve Board (FRB) issued CA letter 11-7 "Funds Availability and Payment of Interest" that provides information about two provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act) that took effect July 21, 2011.

First, CA 11-7 clarifies that supervised institutions must comply with the increased funds availability rule as amended by Dodd-Frank. Beginning July 21, institutions must make the first $200 of amounts deposited by check available to a customer by the next business day after the deposit was received. In March, the FRB proposed revisions to Regulation CC (Availability of Funds and Collections of Checks) to incorporate this change. Although the rule has not been finalized, the FRB state it expects institutions to comply with the applicable statutory requirements.

CA 11-7 addresses the repeal of Regulation Q, which had prohibited institutions from paying interest on demand deposit accounts. The letter states that member banks are now able, but not required, to pay interest on demand deposit accounts. If a bank decides to pay interest on some or all of its demand deposit accounts, it will need to notify affected customers that the account is no longer eligible for unlimited deposit insurance coverage as a noninterest-bearing transaction account.

Financial Stability Oversight Council (FSOC) to Re-Propose and Offer More Guidance on Designating Nonbank Financial SIFIs

Confirming earlier indications by Treasury and several other member agencies, the FSOC in a letter dated August 10, 2011 to Congressman Randy Neugebauer (R - TX) stated that it intends to re-propose its rule for the designation of nonbank financial systemically important financial institutions (SIFIs) and include proposed guidance for public comment. Congressman Neugebauer is Chairman of the Subcommittee on Oversight and Investigations of the House Financial Services Committee. The proposed rule will focus on procedures for designation, while the proposed guidance is intended to provide further clarity on the FSOC's approach to designation. The guidance will set forth both quantitative metrics to be used by the FSOC, in addition to qualitative considerations that will assist its members in assessing the "threat to financial stability" a nonbank financial company may pose should it encounter substantial financial difficulties. The guidance will also include the primary factors to be used in vetting the ten statutory considerations and will be adjusted over time

to respond to emerging threats. A 60 day comment period will be provided on the re-proposed rule and guidance when issued.

The Basel Committee in July released a Consultative Document providing a proposed assessment methodology for identifying global systemically important banks -- G-SIBS, which included both metrics and the exercise of judgment. The Basel effort, however, was limited to banking organizations. What influence or relevance, if any, the Basel effort may have on the FSOC approach to designating nonbank financial SIFIs will not be known until the proposed guidance is released. Certainly of some relevance is the metric/indicator approach of the Basel paper, which gave an equal weight to five categories of systemic importance -- size, cross-jurisdictional activity, interconnectedness, substitutability and complexity.

Treasury Office of Financial Research Discusses Progress and Timeline on Global Initiative to Establish a Legal Entity Identifier

On August 12, Treasury's Office of Financial Research (OFR) created by Dodd-Frank issued a statement on the progress made to date and next steps forward in the global initiative to establish a Legal Entity Identifier (LEI). An LEI is a unique number that would identify a legally distinct entity that engages in financial market activities. Currently, there are many ways to identify entities, but there is no universal identification scheme for legal entities across markets and jurisdictions.

In November 2010, the OFR stated that if a universal LEI was established by July 15, 2011, it planned to issue a notice of proposed rulemaking that would require the LEI to be used for data reported to the OFR. Although significant progress has been made to date, the OFR indicated that additional work needs to be done to build international consensus on key issues before the OFR issues a rule. The Financial Stability Board (FSB) is hosting a workshop on September 28 and 29 to discuss how to coordinate work on LEI and move the initiative forward. Additionally, the OFR believes that sufficient progress can be made to allow for an initial phase of implementation in 2012, consistent with the needs of regulatory authorities in a variety of jurisdictions.

A task force of the Basel Committee on Payment and Settlement Systems and the International Organization of Securities Commissions has been evaluating the potential use of an LEI for over-the-counter (OTC) derivative reporting worldwide. In the United States, the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) proposed rules for swap reporting and expressed a preference for using an LEI for that reporting, if it can be established through international consensus and is available in a timely manner. The Canadian Securities Administrators published a consultation paper calling for each participant conducting a derivative transaction in Canada to be assigned an LEI based on universal internationally accepted standards. Recently, the Hong Kong Monetary Authority (HKMA) published a consultation paper on reporting to the Hong Kong Trade Repository (HKTR), which states that the HKTR will work with the HKMA to consider how to incorporate a global LEI into that reporting.

The OFR stressed that private sector participation and expertise in this process is "essential," and private industry has made significant strides in helping to develop an LEI. A global coalition of financial services firms and trade associations developed common requirements for an LEI to attempt to maximize its utility to both the private and public sectors, and the coalition recently published a recommendation for how an LEI could be implemented. The International Organization for Standardization also has developed a draft technical specification for the identifier (ISO 17442), which the global coalition of financial services firms and trade associations recommended be part of the solution. The OFR will continue to consult with these organizations and other members of the private sector to make sure that all stakeholders have adequate opportunity to inform future decisions.

OCC and Federal Reserve Offer More Guidance on Thrift and Thrift Holding Company Supervision

The OCC recently published in the Federal Register an interim final rule dealing with its assumption on July 21, 2011 of all functions of the Office of Thrift Supervision (OTS) and the Director of OTS with respect to Federal savings associations (federal thrifts). The OCC has responsibility for the ongoing supervision, examination and regulation of all federal thrifts, as well as the rule-making authority for such institutions. In its interim final rule, the OCC has republished in 12 CFR Chapter 1 (the OCC Chapter) all OTS regulations from 12 CFR Chapter V that the OCC has authority to promulgate and enforce, with appropriate nomenclature and other technical changes. However, the OCC noted that it did not republish certain OTS regulations that have been changed by Dodd-Frank. Specifically, the OCC did not republish the OTS "field" preemption rules because under Dodd-Frank, effective July 21, 2011, preemption determinations for federal thrifts must be made in accordance with the laws and legal standards applicable to national banks under Dodd-Frank. The OCC also did not republish OTS rule-making authority with respect to transactions with affiliates, insider transactions or anti-tying as those matters were transferred by Dodd-Frank to the FRB. The OCC also did not republish those OTS rules relating exclusively to savings and loan holding companies (SLHCs) because the OTS rule-writing and supervisory authorities in this area have also been transferred to the FRB.

In a similar vein, the FRB has recently published a proposed rule setting forth those OTS rules for SLHCs that it will continue to enforce and those that it will not. The FRB will continue to enforce substantive rules for SLHCs dealing with acquisitions and permissible activities, including the required filing of applications. However, rules for processing applications will be those used currently for bank holding companies (BHCs) in equivalent situations. The FRB does not intend to transfer or enforce OTS rules pertaining to control determinations for SLHCs, but will insert provisions equivalent to those applicable to BHCs. The FRB has also issued SR 11-13 providing supervisory guidance that effective July 21, 2011, any savings association that is a subsidiary of a SLHC must provide notice to the FRB at least 30 days before declaring a dividend. The duty to review and process these notices is a new responsibility that has been assumed by the FRB as part of the supervisory and rulemaking authority previously held by the OTS. The 30-day prior notice is required by Dodd-Frank, which also provides that the 30-day period runs from the date the notice is submitted to the agency, and that a dividend declared during the review period or without filing the notice is null and void.

In SR 11-12, the FRB provides guidance for those thrifts that wish to take advantage of a Dodd-Frank provision that excludes from the definition of an SLHC any company that controls only one savings association subsidiary, provided that subsidiary functions solely in a trust or fiduciary capacity as described in section 2(c)(2)(D) of the Bank Holding Company Act. As of July 22, 2011, an SLHC that qualifies for this exclusion may submit a request to the FRB to deregister as an SLHC. In requesting deregistration as an SLHC, the company must affirm that its sole savings association's activities meet the requirements for this exclusion as follows: (1) all or substantially all of the deposits of such institution are in trust funds and are received in a bona fide fiduciary capacity; (2) no deposits of such institution which are insured by the Federal Deposit Insurance Corporation (FDIC) are offered or marketed by or through an affiliate of such institution; (3) such institution does not accept demand deposits or deposits that the depositor may withdraw by check or similar means for payment to third parties or others or make commercial loans; and (4) such institution does not (a) obtain payment or payment-related services from any Federal Reserve Bank or (b) exercise discount or borrowing privileges.

Federal Reserve Takes Flexible Approach on New Regulatory Reporting by Thrift Holding Companies

Effective July 21, 2011, the FRB became responsible for consolidated supervision of SLHCs. On February 8, 2011, the Federal Reserve proposed that beginning with March 31, 2012 reporting period; it would require SLHCs to submit the same regulatory reports as BHCs. This was not an insubstantial change. SLHCs currently file an H-(b)(11) annual report and a Schedule HC to the quarterly Thrift Financial Report. In comparison, BHCs file an FR Y-6 or FR Y-7 Annual Report; the FR Y-9 family of five reports; the FR Y-10 Report on changes in operations and activities within 30 days after their occurrence; the FR Y-11 family of reports on US nonbank subsidiaries; the FR 2314 family of reports on international subsidiaries; the FR Y-7 series of reports for foreign banking organizations. The FR Y-8 report on affiliate transactions and the FR Y-12 reports on merchant banking investments.

The FRB views its regulatory reporting requirements for BHCs as a means to detect emerging financial problems, to review performance, to monitor capital and capital adequacy, to evaluate mergers and acquisitions and to analyze a BHC's overall financial condition. These reasons are particularly true for the Y-9 series of reports, especially the Y-9C and Y-9LP which are standardized financial statement for the consolidated BHC and parent. Simply put, these reports are critical to offsite supervision.

However, in response to comments received on its original proposal, the FRB recognized that more time would be needed to implement fully the BHC reporting requirements and that a limited number of firms should be exempted internationally due to their structure or circumstances. For other SLHCs, BHC reporting would be phased-in over two years, beginning no sooner than March 31, 2012. The following chart summarizes the reporting program developed by the FRB:

SLHCs	Thrift Reports-- 2011 and 2012	BHC FR Y-9 Series & FR Y-6 or Y-7 Annual Reports -- 2012	FR Y-10 Structure and Activity Information --2012	Other BHC Reports -- 2013
Exempt SLHCs - --- - Grandfathered Unitary SLHCs with Thrifts Making up less than 5% of SLHC consolidated assets as of prior quarter-end - SLHC where Top-Tier HC is an Insurance Company that only prepares financial statements using Statutory Accounting Principles (SAP)	• Continue to file OTS Form H-(b)11 for 2011 and 2012 (Federal Reserve to provide further info on transmission later in 2011) • Continue to file Schedule HC to Thrift Financial Report in 2011 and 2012 (details for 2012 to be described in a separate notice by the Federal Reserve)	• File only FR Y-6 or FR Y-7 Annual Report in	Federal Reserve to propose means to collect FR Y-10 type information in 2011 or early 2012	None -- Federal Reserve will rely on reports filed with other regulators (SEC, State Insurance Regulator)
Other SLHCs	• Continue to file OTS Form H-(b)11 for 2011 and 2012 (Federal Reserve to provide further info on transmission later in 2011) • Continue to file Schedule HC to Thrift Financial Report in 2011	Beginning no sooner than March 31, 2012 • File FR Y-9 Series as applicable (Schedule HC-R in Y 9-C on regulatory capital not required until consolidated capital requirements for SLHCs are established (2015) • File FR Y-6 or Fr Y-7 Annual Report	Federal Reserve to propose means to collect FR Y-10 type information in 2011 or early 2012	In 2013 • Submit all BHC reports as applicable to the SLHC

FHFA, Treasury and HUD Seek Input on Disposition of Real Estate Owned Properties

The Federal Housing Finance Agency (FHFA), in consultation with the Department of the Treasury and Department of Housing and Urban Development (HUD), has announced a Request For Information (RFI), seeking input on new options for selling single-family real estate owned (REO) properties held by Fannie Mae and Freddie Mac (the Enterprises), and the Federal Housing Administration (FHA).

"While the Enterprises will continue to market individual REO properties for sale, FHFA and the Enterprises seek input on possible pooling of REO properties in situations where such pooling, combined with private management, may reduce Enterprise credit losses and help stabilize neighborhoods and home values," said FHFA Acting Director Edward J. DeMarco. "Partnerships involving Enterprise Properties may reduce taxpayer losses and meet the Enterprises' responsibility to bring stability and liquidity to housing markets. We seek input on these important questions."

The RFI calls for approaches that achieve the following objectives:

- reduce the REO portfolios of the Enterprises and FHA in a cost-effective manner;
- reduce average loan loss severities to the Enterprises and FHA relative to individual distressed property sales;
- address property repair and rehabilitation needs;
- respond to economic and real estate conditions in specific geographies;
- assist in neighborhood and home price stabilization efforts; and
- suggest analytic approaches to determine the appropriate disposition strategy for individual properties, whether sale, rental, or, in certain instances, demolition.

FHFA, Treasury and HUD anticipate respondents may best address these objectives through REO to rental structures, but respondents are encouraged to propose strategies they believe best accomplish the RFI's objectives. Proposed strategies, transactions, and venture structures may also include:

- programs for previous homeowners to rent properties or for current renters to become owners ("lease-to-own");
- strategies through which REO assets could be used to support markets with a strong demand for rental units and a substantial volume of REO;
- a mechanism for private owners of REO inventory to eventually participate in the transactions; and
- support for affordable housing.

Commodity Futures Trading Commission

CFTC Releases Final Swap Data Repository Rule

The CFTC released its final rule on swap data repositories (SDRs) that covers registration standards, core principles and duties. SDRs are a critical part of the Dodd-Frank effort to promote market transparency and support regulatory oversight. Dodd Frank requires data regarding every swap in effect on or after July 21, 2010, to be reported to an SDR or the CFTC. SDRs perform specific functions regarding collecting and maintaining swap data and making this information directly and electronically available to regulators.

After swap definitions become final, any entity that functions as a swap data repository (i.e., "collects and maintains information or records with respect to transactions or positions in, or the terms and conditions of, swaps entered into by third parties for the purpose of providing a centralized recordkeeping facility for swaps")

must be registered with the CFTC. The final rule permits provisional registration if the applicant is in substantial compliance with the registration standards. It also must be able to operate 24 hours per day six days per week. Foreign entities may register as SDRs under the same standards and procedures as domestic entities.

A registered SDR must: (1) accept data; (2) confirm with both counterparties the accuracy of submitted data; (3) maintain data according to standards prescribed by the Commission; (4) provide direct electronic access to the Commission or any designee of the Commission (including another registered entity); (5) provide public reporting of swap data in the form and frequency required by the Commission; (6) establish automated systems for monitoring and analyzing data (including the use of end user clearing exemptions) at the direction of the Commission; (7) maintain user privacy; (8) on a confidential basis, pursuant to section 8 of the CEA,9 upon request and after notifying the Commission, make data available to other specified regulators; and (9) establish and maintain emergency and business continuity-disaster recovery procedures. An SDR also must (i) maintain sufficient financial resources; (ii) furnish market participants with a disclosure document setting forth the risks and costs associated with using the services of an SDR; and (iii) provide fair and open access and fees and charges that are equitable and non-discriminatory.

The conduct rules for SDRs seek to protect a certain level of market competition. The regulation will not permit an SDR to "adopt any rule or take any action that results in any unreasonable restraint or trade, or impose any material anticompetitive burden on the trading, clearing or reporting of transactions." Its governance must be transparent and its rules must minimize conflicts of interest.

Once registered, an SDR must specify the asset class or classes for which they will accept swap data and undertake to accept all swaps in asset classes for which they have specified. The final rule clarifies instruments that fall within certain asset classes, such as currency swaps.

An SDR's duty to confirm the accuracy of swap data with both swap counterparties creates some special obligations that vary depending on which swap counterparty has the duty to report data, and which data is being reported. The final rule summarizes these data reporting requirements as follows:

As detailed in proposed part 45, the reporting of swap creation data (primary economic terms data and confirmation data) and swap continuation data will take place through different channels, depending on the nature of the transaction and counterparties. Primary economic terms data is required to be reported by a SEF or DCM if the swap is executed on a platform, and by the reporting counterparty (SD, MSP, or other counterparty) if the swap is not platform executed. Confirmation data will be reported by a DCO if the swap is cleared and by the reporting counterparty if the swap is uncleared. Swap continuation data will be reported throughout the life of a swap by the DCO and/or the reporting counterparty. Consistent with proposed part 45 and § 49.12, SDRs are required to accept swap data from these entities, as well as from third-party service providers who may be acting on their behalf.

With respect to confirmation of data, an SDR is not "required to affirmatively communicate with both counterparties when data is received from a SEF, DCM, DCO, or third-party service provider under certain conditions. Communication need not be direct and affirmative where the SDR has formed a reasonable belief that the data is accurate, the data or accompanying information reflects that both counterparties agreed to the data, and the counterparties were provided with a 48-hour correction period. The SDR must affirmatively communicate with both counterparties to the swap when data is submitted directly by a swap counterparty such as an SD, MSP or non-SD/MSP counterparty such as an end-user."

To support the CFTC's market oversight function, an SDR must: "(1) monitor, screen, and analyze all swap data in their possession as the Commission may require; (2) develop systems and resources as necessary to execute any monitoring, screening, or analyzing functions assigned by the Commission; and (3) monitor, screen, and analyze swap transactions which are reported to the SDR as exempt from clearing pursuant to...the end-user clearing exemption."

The final rule also contains numerous other topics, including rules governing the use and ownership of swap data, interaction with real time data reporting and maintaining data privacy.

This final rule will become effective within 60 days after publication in the Federal Register, which is pending. Once effective, entities may apply for registration as an SDR. Mandatory registration and compliance with the registration rules will not be required until the swap definition rulemaking becomes effective.

CFTC Releases Final Whistleblower Rule

The CFTC adopted a final rule to implement its whistleblower program as established by Dodd-Frank. . The final rules amend Section 23 of the Commodities Exchange Act (CEA) to require whistleblower program that requires the CFTC to pay an award, subject to certain limitations, to eligible whistleblowers who voluntarily provide the CFTC with original information about a violation of the CEA that leads to the successful enforcement of a covered judicial or administrative action, or a related action. The Act also prohibits retaliation by employers against individuals who provide the CFTC with information about possible CEA violations.

In adopting the rule, the CFTC endeavored to harmonize its whistleblower rules with those of the SEC, and made certain revisions. Like the SEC whistleblower rules, the CFTC has chosen not to require whistleblowers to report information internally to a company in order to be considered for an award. In addition, the CFTC also streamlined its procedures for Submitting Information and Claims by combining the two proposed forms into one form. Finally, the final rules provide greater clarity and specificity about the scope of the exclusions applicable to senior officials within an entity who learn information about misconduct in connection with the entity's processes for identifying, reporting, and addressing possible violations of law.

The rule becomes effective October 24, 2011.

CFTC Releases Final Rule on Agricultural Swaps

This final rule is one of several rules needed to subject agricultural swaps to Dodd-Frank regulation on the same basis as other swaps. The CFTC previously issued a final rule defining the term "agricultural commodity" as part of this exercise. This rule modifies existing CFTC regulations to permit the transaction of swaps in an agricultural commodity subject to all rules and regulations applicable to any other swap.

The rule becomes effective December 31, 2011.

Securities And Exchange Commission

SEC Office of the Whistleblower: Open for Business

Sean McKessy is the first Chief of the SEC's new Office of the Whistleblower, which opened its doors on August 12, 2011. The day prior, Chief McKessy addressed a conference at Georgetown University where he summarized the rules and sought to dispel some "misunderstandings" about the new rules. The most controversial element of the new rule is that it provides a monetary incentive of between 10 and 30 percent of sanctions collected by the SEC for whistleblowers who voluntarily provide the SEC with information that leads to a successful SEC action with sanctions exceeding $1 million.

Contrary to some corporate views, Chief McKessy believes that the new program "will bolster, not hamper, the internal compliance systems at companies across the country." The rules specify that employees who report wrongdoing internally first and, within 120 days, then report to the SEC benefit in two ways. First, employees

will be deemed to have reported the information to the SEC on the date they reported internally. Second, those employees who report internally benefit from the information uncovered by the company in its own investigation. Chief McKessy's point is that an employee who reports directly to the SEC may be unable to produce enough information for the SEC to generate an investigation; whereas when he or she reports internally, if the internal investigation results in substantial more proof of wrongdoing, the employee is likely to receive a higher award based upon the enhanced quality and volume of the information that led to sanctions.

Chief McKessy also clarified that in most instances under the rules, attorneys, compliance and internal audit personnel and external auditors will not be allowed to become whistleblowers. These types of professionals may only qualify in very limited circumstances -- when necessary to prevent imminent or ongoing conduct or the misconduct has been identified and reported but not remediated in a timely fashion. In particular, attorneys may not break the attorney-client privilege for the purpose of reporting and receiving an award. With respect to external auditors, eligibility is limited to a case where the auditors have a reasonable basis to believe their employer -- the audit firm --failed to make the required disclosures of the audit client's wrongdoing under Section 10A of the Exchange Act. In these rare instances, the eligibility for an award is limited to the reporting of misconduct that has been detected but not reported to the SEC.

Lastly, Chief McKessy noted that even before the rules went into effect, there has been an increase in the quality of the tips it has received.

SEC Adopts Large Trader Reporting Rule

On July 26, 2011, the SEC adopted a final rule establishing large trader reporting requirements under the Exchange Act. The final rule will require a "large trader," defined as a person whose transactions in national market securities (NMS securities) equal or exceed 2 million shares or $20 million during any calendar day, or 20 million shares or $200 million during any calendar month, to identify itself to the SEC and make certain disclosures on new Form 13H. The SEC will assign each large trader a unique identification number, which the trader then must provide it to its registered broker-dealers and highlight all accounts to which it applies.

Under the final rule, broker-dealers will be required to maintain additional transaction records for each large trader. The SEC also is requiring that broker-dealers report large trader transactions to the agency upon request. In addition, broker-dealers will be required to perform limited monitoring of their customers' accounts for activity that may trigger the large trader identification requirements.

The final rule becomes effective October 3, 2011. Large traders must identify themselves to the SEC by filing new Form 13H by December 1, 2011. Broker-dealers must maintain records, report and monitor trading activity of large traders on April 30, 2012.

SEC Adopts Security Ratings Rule

To comply with Dodd-Frank Section 939A, on July 26, 2011, the SEC adopted final rules that remove references to credit ratings in forms and rules under the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 that relate to short form registration (Forms S-3 and F-3). The rule also rescinds Form F-9, the form used by Canadian issuers to register non-convertible investment grade debt.

Instead of credit ratings criteria, issuers will need to satisfy one of four new tests in order to use Form S-3 or Form F3:

- The issuer has issued (as of a date within 60 days prior to the filing of the registration statement) at least $1 billion in non-convertible securities other than common equity, in primary offerings for cash,

not exchange, registered under the Securities Act, over the prior three years.

- The issuer has outstanding (as of a date within 60 days prior to the filing of the registration statement) at least $750 million of non-convertible securities other than common equity, issued in primary offerings for cash, not exchange, registered under the Securities Act.
- The issuer is a wholly-owned subsidiary of a well-known seasoned issuer as defined under the Securities Act.
- The issuer is a majority-owned operating partnership of a real estate investment trust that qualifies as a well-known seasoned issuer.

To ease transition for companies, the rules include a temporary three-year grandfathering provision that allows an issuer to use Form S-3 or Form F3 for three years from the effective date of the rule amendments if it would have met the requirements of the old rule.

The final rule becomes effective September 2, 2011, save for certain amendments related to the rescission of Form F9 that take effect December 31, 2012.

MSRB Rulemaking Under Dodd-Frank

Dodd-Frank requires that municipal advisors register with the SEC and granted the Municipal Securities Rulemaking Board (MSRB) the authority to regulate municipal advisors. The SEC implemented a temporary registration regime for municipal advisors effective October 1, 2010 that will expire on December 31, 2011. On December 20, 2010, the SEC proposed a rule for permanent registration of municipal advisors on which approximately 1,000 comment letters have been received, including many expressing concerns regarding the treatment of appointed officials and traditional banking products and services.

Municipal advisors provide advice to state and local governments and other borrowers involved in the issuance of municipal securities or with respect to the investment of governmental monies. Municipal advisors also solicit business from a state or local government for a third party. Subject to certain exemptions, the definition of municipal advisor under the Dodd-Frank Act includes financial advisors, guaranteed investment contract brokers, third-party marketers, placement agents, solicitors, finders, and certain swap advisors that provide municipal advisory services. Following are a series of rules or interpretive notices that were filed by the MSRB with the SEC during the month of August.

MSRB Files with SEC Proposed Interpretation of Application of Conduct Rule to Underwriters of Municipal Securities

On August 2, 2011, the MSRB filed a proposed interpretive notice (Notice) with the SEC concerning the application of MSRB Rule G-17, which outlines the conduct of municipal securities and municipal advisory activities, to underwriters of municipal securities. The MSRB proposed that the Notice be made effective 90 days after approval by the SEC

Currently, Rule G-17 requires brokers, dealers and municipal securities dealers to deal fairly with all persons and must not engage in any deceptive, dishonest, or unfair practice. The MSRB is proposing to provide additional interpretive guidance that addresses how Rule G-17 applies to dealers in their interactions with municipal entities as underwriters of municipal securities, as well as integrally-related activities, such as interest rate swap transactions.

The Notice provides guidance on the following areas:

Representations to Issuers. All representations made by underwriters to issuers of municipal securities in connection with municipal securities underwritings must be truthful and accurate and must not misrepresent or omit material facts.

Required Disclosures to Issuers. The Notice states that an underwriter in a negotiated offering that recommends a complex municipal securities financing to an issuer has an obligation to make more particularized disclosures than those that may be required in the case of routine financing structures. The level of disclosure required may vary according to the issuer's knowledge or experience with the proposed financing structure or similar structures, capability of evaluating the risks of the recommended financing, and financial ability to bear the risks of the recommended financing, in each case based on the reasonable belief of the underwriter. In all events, the underwriter must disclose any incentives for the underwriter to recommend the complex municipal securities financing and other associated conflicts of interest.

Underwriter Duties in Connection with Issuer Disclosure Documents. The Notice would provide that a dealer's duty to have a reasonable basis for the representations it makes, and other material information it provides, to an issuer and to ensure that such representations and information are accurate and not misleading, as described above, extends to representations and information provided by the underwriter in connection with the preparation by the issuer of its disclosure documents (*e.g.*, cash flows).

Underwriter Compensation and New Issue Pricing. The Notice outlines factors relevant to determining whether an underwriter's compensation is disproportionate to the nature of the underwriting and related services performed and thus violates Rule G-17. Those factors include the credit quality of the issue, the size of the issue, market conditions, the length of time spent structuring the issue, and whether the underwriter is paying the fee of the underwriter's counsel or any other relevant costs related to the financing.

The Notice also provides that the duty of fair dealing under Rule G-17 includes an implied representation that the price an underwriter pays to an issuer is fair and reasonable, taking into consideration all relevant factors, including the best judgment of the underwriter as to the fair market value of the issue at the time it is priced. In a negotiated underwriting, the underwriter has a duty under Rule G-17 to negotiate in good faith with the issuer. This duty includes the obligation of the dealer to ensure the accuracy of representations made during the course of such negotiations, including representations regarding the price negotiated and the nature of investor demand for the securities.

Conflicts of Interest. The Notice would require disclosure of potential conflicts of interest, including third-party payments, values or credits made or received, profit sharing with investors, and the issuance or purchase of credit default swaps.

MSRB Files with SEC Proposed Amendments to Rule on Gifts and Gratuities

On August 4, 2011, the MSRB filed with the SEC proposed amendments to its rules on gifts and gratuities (Rule G-20) in order to make the rule applicable to municipal advisors, as well as related proposed changes to the MSRB's books and records requirements. The amendments are part of the MSRB's mandate to establish a comprehensive regulatory regime for all municipal advisors. The MSRB requests that the proposed rule change be made effective on the date that rules defining the term "municipal advisor" under the Securities Exchange Act of 1934 ("Exchange Act") are first made effective by the SEC.

The proposed amendments to Rule G-20 would prohibit municipal advisors, in connection with their municipal securities activities or municipal advisory activities, from, directly or indirectly, making a gift or permitting a gift to be made in excess of $100 per year to a natural person other than an employee or partner of the municipal advisor, if such gifts are in relation to the activities of the employer of the recipient of the gift. The rule does provide, however certain exemptions for occasional gifts of meals or tickets to theatrical, sporting and other entertainments hosted by the municipal advisor; or sponsoring legitimate functions that are

recognized by the Internal Revenue Service as deductible business expenses. In addition, the provisions of Rule G20 would not apply to compensation or employment contracts for services rendered by a person other than an employee of the municipal advisor, provided that there is a written agreement between the advisor and the person who is to perform such services.

In addition, municipal advisors would be required to maintain and preserve certain records concerning gifts made pursuant to Rule G-20.

MSRB Files with SEC Proposed Rules on Fiduciary Duty for Municipal Advisors and Supervision of Municipal Advisory Activities

On August 22 and 23, 2011, the MSRB filed with the SEC two proposed rule changes that would significantly affect how municipal advisors conduct their activities. The MSRB in each case requests that the proposed rule changes or interpretations be made effective on the date that rules defining the term "municipal advisor" under the Exchange Act are first made effective by the SEC.

Supervision of Municipal Advisory Activities

First, the MSRB proposed a rule regarding the supervision of municipal advisory activities. The proposed rule sets forth a municipal advisor's obligation to supervise the conduct of the municipal advisory activities of the municipal advisor and its associated persons to ensure compliance with applicable MSRB and SEC rules.

Supervisory System. The proposed rule would require municipal advisors to establish a supervisory system that, at a minimum, must include:

- The establishment and maintenance of written procedures;
- Designation of the municipal advisor principal(s) responsible for supervision and a written record of each supervisory designation and of the designated principal's responsibilities;
- Reasonable efforts to determine that all supervisory personnel are qualified by virtue of experience or training to carry out their assigned responsibilities with respect to municipal advisory activities; and
- Annual participation of each associated person, in an interview or meeting conducted by persons designated by the municipal advisor at which compliance matters relevant to the municipal advisory activities of the associated persons are discussed. A record of the content of the interview or meeting, as well as a list of attendees, must be maintained.

Written Supervisory Procedures. In addition, municipal advisors would be required to create and maintain written supervisory procedures. The procedures, at a minimum, would include:

- The manner in which a designated principal shall monitor compliance and supervise municipal advisory activities;
- A periodic review, no less than every three years, by a designated principal of each office that engages in municipal advisory activities;
- The maintenance and preservation of books and records; and
- The maintenance of the written supervisory procedures, a copy of which would be required to be made available in each office of the municipal advisor and in each office where supervisory activities with respect to municipal advisory activities are conducted.

Internal Inspections. Municipal advisors also would be required to review, at least annually, the municipal advisory activities of the firm.

Books and Records. Finally, the MSRB proposed changes to its rules relating to books and records. The proposed amendments would require the following records to be kept:

- the designations of municipal advisor principals and their responsibilities;
- the content of each annual compliance interview or meeting and a list of attendees;
- the written supervisory procedures;
- the results of the designated principal(s) annual review of the municipal advisory activities of the firm; and
- correspondence and any other written and electronic communications of associated persons.

New Fiduciary Duty for Municipal Advisors

The MSRB also proposed new Rule G-36, which would require municipal advisors to be subject to a fiduciary duty, including a duty of loyalty and care when conducting activities on behalf of its municipal advisory clients.

In addition the MSRB filed a proposed interpretive notice (Notice) concerning the application of the rule to municipal advisors. First, the Notice expressly states that municipal advisors' fiduciary duty to municipal entity clients "goes beyond and encompasses the obligation under MSRB Rule G-17 for municipal advisors, in the conduct of their municipal advisory activities, to deal fairly with all persons and not engage in any deceptive, dishonest, or unfair practice." A municipal advisor's violation of Rule G-17 with respect to a municipal entity client thus would be a violation of Rule G-36.

Duty of Loyalty

A municipal advisor's duty of loyalty requires the municipal advisor to deal honesty and in good faith with the municipal entity and to act in the municipal entity's best interests without regard to financial or other interests of the municipal advisor.

A municipal advisor must disclose all municipal conflicts of interest, such as payments made for the purpose of obtaining or retaining municipal advisory business, and obtain written consent to its conflicts by an official of the municipal entity. Further, where a municipal advisor is unable to manage its conflicts, it cannot engage in municipal advisory activities with respect to a municipal entity client. In most cases under Rule G-36, a municipal advisor that acts as a principal with its municipal entity client on the same transaction will be considered to have an unmanageable conflict, subject to certain exemptions. This also will be the case if an affiliate of the municipal advisor acts as a principal with the municipal entity on the same transaction.

In fulfilling its duty of loyalty, the municipal advisor also must provide written disclosure to its municipal entity client the amount of its direct compensation and indirect compensation (e.g., amounts paid to affiliates) it will receive from an engagement, as well as the scope of services to be provided for that compensation. Excessive compensation (i.e. a municipal advisor's compensation that is disproportionate to the nature of the services performed) would constitute a violation of the municipal advisor's duty of loyalty.

Duty of Care

As provided in proposed Rule G-36, a municipal advisor's fiduciary duty to its municipal entity client also includes a duty of care, meaning that a municipal advisor must exercise due care in performing its responsibilities. Pursuant to this duty, the municipal advisor may not undertake a municipal advisory engagement for which the advisor does not possess the requisite degree of knowledge and expertise needed to provide the municipal entity with informed advice. In addition, unless that duty has been expressly disclaimed, the municipal advisor has a duty to investigate and advise the municipal entity of alternatives to the proposed financing structure or product that are then reasonably feasible based on the issuer's financial circumstances and market conditions at the time.

Moreover, in carrying out its duty of care, the Notice provides guidance regarding a municipal advisor's duty to make municipal advisor must make reasonable inquiry as to facts that are relevant to a municipal entity's determination of whether to proceed with a course of action (e.g. the issuance of municipal securities, entering into a derivative contract, or making an investment).

The notice makes clear that the duty of care requires only that the municipal advisor act competently and

provide advice to the municipal entity after making reasonable inquiry into the representations of the municipal entity's counterparties, as well as then reasonably feasible alternatives to the financings or products proposed. Further, a municipal advisor may limit the scope of its engagement with municipal entity clients in certain instances.

International Organizations

UK Financial Services Authority Issues Consultation Paper Regarding Recovery and Resolution Plans

On August 9, the UK Financial Services Authority (FSA) issued a consultation paper on recovery and resolution plans (RRPs), as required by the Banking Act of 2009, to be created for deposit-takers and certain investment firms. The paper acknowledges that the scope of regulations remains under consideration, but the current proposal is that investment firms with assets of GBP15 billion or more will be subject to the requirement. The FSA is seeking comments, due by November 9, 2011.

RRPs will be required to consider two aspects: 1) recovery plans identifying options to recover financial "strength and viability" in the event the institution comes under severe economic stress, and 2) resolution plans, which include detailed information about the business structure and activities of the institution in the form of a "resolution pack," allowing regulators to conduct an orderly resolution.

The paper describes that "recovery plans should be capable of being implemented swiftly when required" and integrated in the institution's risk management framework. The FSA will require each plan to describe several credible options that can be executed as conditions and circumstances warrant. Such options should be based on qualitative and quantitative triggers for implementing one or more of the options and minimum criteria and institutions should be able to demonstrate material benefits are realizable within an "acceptable period of time", generally defined by the FSA as six months. The plans will be required to be submitted to the FSA as part of the supervisory process, with regular administration by a nominated executive director and at least annual approval by the institution's Board of Directors or other senior governance committee. Guidance from the FSA for items to include in recovery plans include:

- Options for restoring capital, liquidity, and profitability, considering the effects on profitability and ensuring that recovery options do not solve short-term capital or liquidity problems at the expense of long-term financial viability.
- Disposal of business activities/portfolios or entities, including the possible sale of the entire firm to a third party, considering long-term viability after the disposal.
- Use of central bank facilities, such as Bank of England's Discount Window Facility.
- Raising equity capital.
- Ceasing payment of dividends and bonuses.
- Debt exchanges and other liability management.

The paper also describes that resolution plans will be prepared by authorities, likely to be the new Prudential Resolution Authority (PRA) in consultation with the Bank of England and HM Treasury to provide a strategy to unwind a failed firm or group that avoids the need of public support. In support of the plans, institutions will be required to submit a "resolution pack" including:

- Details of significant entities in the group and key structural and operational issues relevant to the separation of significant legal entities, including an explanation as to how capital and funding is allocated and managed across the firm, and financial dependencies within the group of firm.

- Key metrics on economic functions to illustrate their relative importance. This should cover products or activities of the firm whose withdrawal or disorderly wind-down could have a material impact on the economy or financial system.
- A "Critical Function Contingency Analysis" (CFCA) covering separation and/or "controlled wind-down" for each critical function of the firm, the population of which is expected to be agreed with the authorities. The CFCA will analyze how each function can be separated, while either preserving continuity of the function or winding it down in an orderly fashion.
- Plans to overcome any barriers to resolution considered unacceptable by authorities, which may include:
  - Economic functions other than deposit-taking being in entities other than the deposit-takers,
  - Whether critical economic functions are provided through a branch or subsidiary, and
  - Comingling of functions within a single entity.

The FSA also expects that recovery plans will be subject to at least annual review, or more frequently based on reorganizations or major acquisitions or disposals. Recovery plans must also take into account overseas subsidiaries, even though subject to regulation by another authority. However, the FSA states that each national resolution authority should be ultimately responsible for the legal entities incorporated in its jurisdiction, although it accepts that home and host resolution authorities should cooperate to seek a coordinated resolution of the parent bank and its cross-border entities before any cross-border bank is placed into resolution.

Investment firms are addressed separately in the paper. All firms holding client money and custody assets (irrespective of size) will be required to prepare a client assets resolution pack detailing vital information that will be readily accessible to liquidators. The aim of the pack is to promote the speedier return of client money and assets to customers, once a firm has failed, which has been a significant challenge in the Lehman insolvency.

In the paper, the FSA acknowledges that its authority will be broken up into a new PRA and Financial Conduct Authority (FCA) in the future. However, the FSA believes that most of the proposed rules for the preparation of RRPs will be implemented before the PRA accepts authority for prudential supervision. A policy statement is expected to be published in first quarter 2012 and that firms will be expected to prepare their initial RRPs by June 2012.

The FSA's proposed rules do not apply to UK branches of non-UK banks. Branches of EU banks will be subject to EU rules, which also apply to UK banks, and the FSA acknowledges that it will work with home regulators and other Cross-Border Stability Groups, such as Financial Stability Board and Basel Committee on Banking Supervision. The paper also references the other of other international regulatory agencies, such as the FDIC and FRB, in this regard, which may require banks headquartered outside the US to comply with FDIC and FRB rulemakings. It remains to be seen, however, how much international collaboration there will be following the implementation of rules in the UK, EU, US, and other jurisdictions regarding the preparation of RRPs by large internationally active banks and other financial institutions to ensure such institutions are subject to consistent and non-duplicative requirements. While some European countries, notably the Netherlands, Denmark and Switzerland, have released details of either resolution or recovery plans, the UK proposals are more advanced and will likely contribute to current debates in the EU and further afield. The EU also plans to issue legislative proposals on cross-border bank resolution in September

ESMA Issues Public Statement on Regulatory Action on Short-Selling in the EU

On August 11, 2011, the European Securities and Markets Authority (ESMA) released a public statement to promote harmonized regulatory action on short selling in the European Union (EU).

Given recent market developments that have raised concerns across the EU, ESMA emphasized the requirements in the Market Abuse Directive, including the prohibition on the dissemination of information which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumors and false misleading news. European competent authorities have taken a firm stance against any behavior that breaches these requirements and ESMA will support the national authorities to act swiftly against any such behavior which is clearly punishable. While ESMA acknowledges that short-selling can be a valid trading tragedy, when used in combination with spreading false market rumors, it is clearly abusive.

In addition, competent authorities have reinforced the monitoring of their markets and are keeping their regulatory requirements under review. ESMA has coordinated discussions with between the national competent authorities, specifically on the content and timing of any possible additional measures necessary to maintain orderly markets.

Finally, ESMA announced that Belgium, France, Italy and Spain have decided to impose or extend existing short-selling bans. Although there is no common EU legal framework in the area of short-selling, the countries' measures have been aligned as much as possible.

The measures became effective August 12, 2011.

Additional Information

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