

Financial Services Alert

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Developments of Note

➤ **SEC Issues Release Designed to Codify its Position under the Proxy Rules for Excluding Shareholder Proposals Related to Director Elections**

The SEC issued a formal release (the “Release”) adopting an amendment to Rule 14a-8(i)(8) under the Securities Exchange Act of 1934, as amended, in order to clarify the Rule and codify what it regards as its long-standing interpretation of the Rule, which had been called into question by a recent decision of the US Court of Appeals for the Second Circuit. Rule 14a-8 provides shareholders with an opportunity to place a proposal in an issuer’s proxy materials for consideration at an annual or special meeting of shareholders. A shareholder proposal that meets certain procedural requirements and does not fall within one of the categories of proposals that the Rule allows an issuer to exclude, must appear alongside management’s proposals in the issuer’s proxy materials. Rule 14a-8(i)(8), as revised, specifies that, in addition to being able to exclude a shareholder proposal from its proxy materials when that proposal relates to an election for membership on the issuer’s board of directors or analogous governing body (as currently permitted), an issuer may also exclude a proposal that relates to a procedure for such nomination or election. In the Release, the SEC stressed that the revision would not affect or address any other aspect of its prior interpretations of the exclusion under 14a-8(i)(8). The effective date of the amendment is January 10, 2008.

➤ **Senate Banking Committee Releases Draft Bill on Industrial Loan Companies**

Senate Banking Committee Chairman Christopher Dodd released a draft bill (the “Draft Bill”) on November 30, 2007 that would amend the Federal Deposit Insurance Act to establish industrial bank holding company regulation. The Draft Bill is intended to close a loophole in the law before the current moratorium by the Federal Deposit Insurance Corporation (“FDIC”) on the processing of applications that seek to establish an industrial loan company (“ILC” or, in the plural, “ILCs”) expires on Jan. 31, 2008. FDIC Chairman Sheila Bair has stated that the FDIC will not extend its moratorium past the current January 31 deadline.

The Draft Bill would ban virtually all commercial firms from owning ILCs and would freeze the activities of current commercially-owned ILCs. The Draft Bill would use the strict definition of “commercial” outlined in the Gramm-Leach-Bliley Act of 1999, and would only exempt automakers from the ban on new commercially-owned ILCs. Automakers, furthermore, would only be permitted to use an ILC for purposes already undertaken by an ILC owned by a competing automaker.

The Draft Bill includes a grandfather provision for existing ILCs owned by commercial parents, but imposes several restrictions on such commercially-owned ILCs. In particular, under the Draft Bill,

commercially-owned ILCs: (i) would need to obtain FDIC approval before engaging in any new activities; (ii) would be barred from interstate branching; and (iii) would be barred from opening loan offices and setting-up automated teller machines in states where they do not already have branches.

The Draft Bill also would subject ILC parent companies without an umbrella regulator to consolidated supervision by the FDIC, and would require all depository institution subsidiaries of ILC parents to meet regulatory standards of being "well managed" and "well capitalized."

With the exception of the new exemption for automakers, the Draft Bill is significantly more restrictive than the House legislation that was passed on May 21, 2007 (the "House Bill"). For example, the House Bill, authored by Financial Services Committee Chairman Barney Frank, would allow firms that receive less than 15% of their revenue from commercial activities to own an ILC, and would not require grandfathered commercially-owned ILCs to obtain FDIC approval before expanding their activities.

A Senate Banking Committee aide indicated that the Draft Bill "represents a discussion draft", and that it will likely look different before it is ever passed by the Senate Banking Committee since it will first need to achieve broad bipartisan support.

➤ OCIE Associate Director Discusses Broker-Dealer Risk Management

At the 2007 AICPA/FMD National Risk Conference on the Securities Industry, Mary Ann Gadziala, Associate Director of the SEC's Office of Compliance Inspections and Examinations ("OCIE"), discussed risk management practices for broker-dealers and OCIE's program of examining broker-dealer firms regarding their risk management controls. She noted that although OCIE has focused on the largest and most complex firms in the past, this year it plans to focus more on mid-size firms that have significant customer accounts. She observed that these firms might not be familiar with OCIE's risk management process and added that the SEC has proposed rule amendments that would subject an estimated 500 large firms, many which have not experienced a risk management examination, to require that they keep current records documenting their implemented systems of internal risk management controls. (The SEC proposal was issued in March 2007.) Ms. Gadziala commented that although there is currently no specific rule requiring risk management controls for broker-dealers, except generally for OTC derivative dealers and consolidated supervised entities, having effective risk management controls is a proactive sound practice to protect against significant financial losses, violations of law and investor harm for a firm that is not required to have them. She stated that there is no single blueprint for risk management controls, and that each firm should design and implement a risk management control system based on a number of factors, which she identified. She indicated that effective risk management controls are typically proactive and discussed the manner in which some firms had re-evaluated their control systems in view of changing conditions as a result of recent events in the subprime and credit markets.

Risk Management Principles. Ms. Gadziala identified the following sources of guidance on risk management principles: (a) the Group of 30's 1993 report, "Derivatives: Practices and Principles," (b) materials published by the Bank for International Settlements, the Global Association of Risk Professionals, the bank regulatory agencies, the International Organization of Securities Commissions (IOSCO) and the Counterparty Risk Management Policy Group, (c) Rule 15c3-4 of the Securities Exchange Act of 1934, as amended, and (d) the "Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities."

OCIE Risk Management Examinations. Ms. Gadziala discussed OCIE's risk management examinations in some detail. As a preliminary matter, she noted that all OCIE examinations, including risk management examinations, were generally conducted using the same process, which is briefly described on the SEC website, under "Offices/Divisions-Compliance." Ms. Gadziala indicated that the primary purpose of an OCIE risk management examination is to obtain an understanding of a firm's business activities risks and controls and identify concerns and perceived weaknesses that it is then the firm's responsibility to address. She added that risk management examinations are not primarily meant

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to identify violations and make enforcement referrals. Ms. Gadziala identified different areas reviewed in the course of OCIE's internal control examinations and also discussed a number of practices designed to mitigate risks that had been observed by OCIE during examinations.

➤ **IOSCO Technical Committee Issues Final Report on Soft Dollars**

The Technical Committee of the International Organization of Securities Commissions ("IOSCO") issued a Final Report (the "Report") entitled "Soft Commission Arrangements for Collective Investment Schemes" that sets forth an assessment of key issues identified by the Technical Committee's Standing Committee on Investment Management ("SC5") regarding soft dollar arrangements for collective investment schemes ("CIS"). The Report is based on examination of the regulation (and proposed regulation) by SC5 member jurisdictions of soft dollars involving CIS and CIS operators. The mandate, pursuant to which the Report was produced, also provides that SC5 may, if necessary, seek to develop general principles concerning soft dollar arrangements involving CIS and CIS operators; however, the Report indicates that, at this time, the development of general principles regarding soft dollar arrangements would not be appropriate because the relevant law in many jurisdictions is changing. SC5 will undertake to monitor those changes over the next two years and will determine whether and how general principles may be developed, especially in the areas of limits on the goods and services that can be acquired under soft dollars arrangements, and prior and periodic disclosure of soft dollar arrangements. In addition to a discussion of issues raised by the kinds of benefits realized by CIS operators from soft dollar arrangements and the conflicts of interest that can be created by soft dollar arrangements, the Report includes a summary of responses given by SC5 member jurisdictions to a questionnaire regarding the use and regulation of soft dollar arrangements in their jurisdictions.