

Financial Services Alert

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Developments of Note

➤ **FRB Issues Opinion Letter to Investment Adviser Seeking to Have Affiliated Funds Invest in up to 15% of Voting Stock of Banking Organization**

The FRB issued an opinion letter to a registered investment adviser (the “Applicant”), advising that it may acquire through a variety of customer accounts and investment funds (together, the “Investors”) up to fifteen percent of any class of voting securities of a bank holding company or bank (each, a “Banking Organization”) without being deemed to have acquired “control” of the Banking Organization under the Bank Holding Company Act (“BHC Act”), the Change in Bank Control Act (“CIBC Act”), or the FRB’s Regulation Y. As explained below, in giving this opinion, the FRB placed special emphasis on the nature of the Applicant’s business and investments and on certain commitments made to the FRB by the Applicant.

Under the BHC Act and the rules promulgated under Regulation Y, an individual is deemed to control a Banking Organization if it: (i) directly or indirectly owns, controls or has the power to vote twenty-five percent or more of any class of voting securities of the Banking Organization; (ii) controls the election of a majority of the directors of the Banking Organization; or (iii) directly or indirectly exercises a controlling influence over the management or policies of the Banking Organization. Under the FRB’s Regulation Y, a rebuttable presumption of control is also set forth for BHC Act purposes. Although the Applicant’s proposal did not trigger any of the BHC Act presumption of control provisions under Regulation Y, it did raise an issue as to whether the Applicant would exercise a controlling influence over the management or policies of a Banking Organization

Under the CIBC Act and Regulation Y, an individual is presumed to control a bank holding company or state member bank if it owns, controls, or holds with the power to vote ten percent or more of any class of voting securities of the bank holding company or state member bank and either: (a) the bank holding company or state member bank has registered securities, or (b) no other person owns or controls a greater percentage of the same class of voting securities. Since the Applicant proposed to acquire up to fifteen percent of a class of securities of a Banking Organization through a variety of customer accounts and investment funds, and without regard to whether any such Banking Organization had registered securities or whether it would be the largest shareholder in the Banking Organization, the Applicant would be presumed to control such Banking Organization.

In order to rebut the presumption of control, the Applicant pointed to the fact that: (i) the Applicant and the Investors collectively would not own or control more than fifteen percent of any class of voting securities of a Banking Organization; (ii) none of the Investors nor the Applicant individually would own or control more than ten percent of any class of voting securities of a Banking Organization; and (iii) the Applicant would use its best efforts to vote shares owned or controlled by the Investors in excess of ten percent in the same proportion as all other shares that are not in excess of ten percent and, failing that, the Applicant would not vote any shares in excess of ten percent.

The Applicant further made a number of commitments to the FRB that were designed to mitigate its ability to control a Banking Organization. The FRB, in particular, highlighted the importance of the Applicant's stated commitment that whenever it and the Investors will own or control, in the aggregate, ten percent or more of any class of voting securities of a Banking Organization, the Applicant and the Investors will not, individually or collectively:

- (i) take any action to control the Banking Organization within the meaning of the BHC Act;
- (ii) have any director, officer, or employee interlocks with the Banking Organization;
- (iii) except in the context of a tender offer or in certain other transactions, dispose of voting shares of the Banking Organization, either to any person seeking control over the institution or in block transactions exceeding five percent of any class of voting shares of the institution; or
- (iv) threaten to dispose of voting shares in any manner as a condition of specific action or non-action by the Banking Organization.

The FRB also laid emphasis on the fact that the Applicant is not in the business of operating or controlling Banking Organizations, and that it would not be making proprietary investments in Banking Organizations. Moreover, the Investors are not operating companies, and the Applicant does not lend to the Investors. The proposed acquisitions would be made for investment purposes and with the expectation of resale, and not for the purposes of exercising a controlling influence over a Banking Organization.

Finally, the FRB stated no opinion as to whether a CIBC Act notice would be required for transactions involving direct investments in national banks or state non-member banks.

➤ **FDIC Board Votes to Retain Current Assessment Rates for 2008**

The FDIC Board of Directors voted not to change the assessment rates for 2008 that are charged to banks and thrifts for the FDIC's Deposit Insurance Fund (the "DIF"). The existing assessment rate is 5 to 43 basis points per year for every \$100 of insured deposits. Assessment rates increase with perceived increased risk that a bank or thrift poses to the DIF. Most banks and thrifts fall within the lowest risk category and are charged a rate between 5 and 7 basis points. The FDIC said that the FDIC Board's decision to leave the assessment rates unchanged was consistent with the FDIC Board's objective of increasing the DIF's level of reserves reflected by the Designated Reserve Ratio (the "DRR") to 1.25% of estimated insured deposits before the end of 2009. The DRR was 1.22% as of December 31, 2007. The FDIC said that its desire to increase the DRR reflected the FDIC's concern that banks and thrifts may face challenging economic conditions in 2008 and that there may be further bank failures. The FDIC also noted that there is uncertainty surrounding deposit growth in 2008. The FDIC further stated that it will revisit the issue of assessment rates later in 2008 if the economy makes dramatic shifts in either direction.

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Other Item of Note

➤ **SEC Issues Release Proposing New Rule on Naked Short Sales**

The SEC issued a formal release proposing a new rule intended to address the failures to deliver securities sold short that have been associated with naked short selling. The rule is intended to highlight the liability of persons who deceive specified persons about their intention or ability to deliver securities sold short in time for settlement and then fail to deliver the securities. More detailed coverage of the release will appear in a future edition of the *Alert*.