

# Financial Services Alert

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## Alert on the Web:

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## *Developments of Note*

### ➤ **Supreme Court Rules on Arbitration Clauses in Customer Agreements**

The United States Supreme Court issued a significant opinion for financial institutions with customer agreements containing arbitration clauses. Financial institutions trying to compel arbitration often face “void contract” arguments from parties resisting arbitration that claim the underlying contract is void under state law and no enforceable arbitration exists because the entire contract, including the arbitration clause, is void. In *Buckeye Check Cashing, Inc. v. Cardegna et al.*, No. 04-1264 (Feb. 21, 2006), the Supreme Court rejected this argument, holding that a claim a contract is void or illegal does not invalidate an arbitration clause.

In *Buckeye Check Cashing*, members of a putative class action filed suit in Florida state court, alleging that Buckeye, a payday lender, had charged usurious interest rates and that its customer agreement signed in connection with the payday loans was void because it violated various state lending and consumer protection laws. The Florida Supreme Court upheld denial of Buckeye's motion to compel arbitration. The state supreme court concluded that the question of validity of the customer agreement should be resolved in court before arbitration, not submitted to arbitration.

In a 7-1 decision, the Supreme Court of the United States reversed, holding that even if a contract is alleged to be void, the arbitration clause remains enforceable. The Supreme Court based its decision on prior precedent, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), which recognized the severability principle — that arbitration clauses are evaluated separately from the underlying contracts in which they are contained.

### ➤ **NASD and MSRB Agree to Harmonize Rules Governing Sales of Mutual Funds and 529 Plans**

The NASD and the Municipal Securities Rule Making Board (“MSRB”) issued a joint statement pledging cooperation between them to harmonize rules governing mutual fund sales and sales of interests in Section 529 qualified tuition savings plans. In the joint statement, the NASD and MSRB indicated that they recognize that 529 plans typically use registered mutual funds as their primary investment vehicle and that 529 plan sales raise the same general types of sales practice issues as

mutual fund sales, and therefore believe that the harmonization of MSRB rules and NASD rules will further protect the investing public. The two regulatory bodies agreed, among other things, that the MSRB will adopt rules and interpretations concerning 529 plans that are equivalent to NASD rules and interpretations concerning mutual fund sales practices adopted in the future unless MSRB finds such rules and interpretations are prohibited by law or inappropriate as a result of fundamental differences between these two investment vehicles.

### ➤ **ICI Requests 90-Day Extension of the Compliance Deadline for FINCEN's New Correspondent Account Rule**

The Investment Company Institute (“ICI”) has requested that FinCEN grant a 90-day extension to the compliance deadline for FinCEN’s new correspondent account rule (the “Rule”), issued under Section 312 of the Patriot Act. The ICI has requested the extension to allow its member mutual funds adequate time to implement the due diligence program as required by the Rule (the “Due Diligence Program”) and for FinCEN to address key interpretative issues, such as the applicability of the Due Diligence Program to Fund/SERV accounts.

The Rule, as set forth at 31 C.F.R. §103.176, requires covered financial institutions – including banks, broker-dealers, and mutual funds – to establish and implement a Due Diligence Program reasonably designed to detect and report known or potential money laundering activity conducted through or involving correspondent accounts maintained for non-U.S. financial institutions. Currently, such Due Diligence Programs must be put into place by April 4, 2006, by which time all correspondent accounts established on or after that date must be subjected to the Program’s requirements. The Rule also requires the Due Diligence Program to be applied to pre-existing correspondent accounts by October 7, 2006.

Goodwin | Procter LLP held a webinar on the Rule and its requirements, which is available on the firm’s website at [http://www.goodwinprocter.com/webinar\\_patriotact.asp](http://www.goodwinprocter.com/webinar_patriotact.asp). The *Alert* issued a January 30, 2006 Special Edition providing answers to selected questions raised at the Webinar. The Fact Sheet on the Rule issued by FinCEN was discussed in the December 20, 2005 *Alert*.

### ➤ **Basel Committee Issues Revised Corporate Governance Guidelines**

The Basel Committee on Banking Supervision (the “Basel Committee”) issued revised guidelines (the “Guidelines”) concerning sound corporate governance of banking organizations (“Banks” and each a “Bank”). The Guidelines update a 1999 Basel Committee white paper on Bank corporate governance procedures (the “1999 White Paper”) and reflect public comments on a draft version of the Guidelines issued in July 2005. The Basel Committee states that the Guidelines: (1) are not intended to add a new regulatory layer on top of existing, national statutes; (2) are intended to assist Banks in enhancing their corporate governance framework and to assist Bank supervisors in assessing the quality of their corporate governance framework; and (3) should be implemented in a manner that reflects the size, complexity, structure, economic significance to and risk profile of the Bank.

The Guidelines articulate eight corporate governance principles, including: (1) Board member qualifications, understanding of their role and ability to exercise sound judgment about the Bank’s business; (2) Board oversight of the Bank’s strategy and corporate values; (3) Board establishment and enforcement of clear lines of responsibility and accountability; (4) Board actions to see that senior managers oversee Bank activities in a manner consistent with the policies set by the Board; (5) Board and senior management effective use of internal and external auditors and their work product; (6) Board oversight of compensation policies and procedures; (7) Board actions to see that the Bank is governed in a transparent manner; and (8) Board and senior management knowledge of the Bank’s operational structure, including an understanding of where the Bank operates in jurisdictions, or through structuring that impede transparency.

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The addition of the new 8<sup>th</sup> principle concerning the need to “know your structure” is regarded as a very significant revision from the 1999 White Paper. Increased emphasis is also placed in the Guidelines on Board establishment and implementation of clear lines of responsibility and accountability throughout the Bank. With respect to the need to protect whistleblowers, the Guidelines state that “employees should be encouraged and able to communicate, with adequate corporate protection from reprisal, legitimate concerns about illegal, unethical or questionable practices.”

➤ **FRB Grants 23A Exemption for Foreign Tax Sharing Agreements**

The FRB granted an exemption from Section 23A of the Federal Reserve Act (“Section 23A”) with respect to an Australian subsidiary of a US banking institution acting as the “head company”, and entering in a tax sharing agreement within its bank and nonbank affiliates, to be responsible for paying Australian taxes for the organization (including affiliates outside of the bank chain). The FRB stated that this arrangement created a guarantee of the bank subsidiary on behalf of its nonbank affiliates, and thus would constitute a Section 23A covered transaction. However, the BHC made several commitments in support of its exemption request, including that: (1) the affiliates will pay the head company before the tax payment is due; (2) the parent has guaranteed those affiliate payments; and (3) the arrangement would provide more benefits to the bank chain companies than the nonbank companies (including via use of tax losses). Based on these commitments, the FRB granted the requested Section 23A exemption.

***Other Item of Note***

➤ **Federal Banking Agencies Issue QIS4 Summary**

The federal banking agencies issued summary findings of the Basel II Quantative Impact Study 4 (“QIS4”). The capital reduction concerns raised by QIS4 were discussed in the May 24, 2005 *Alert*. A copy of the summary is located at

<http://www.federalreserve.gov/BoardDocs/Press/bcreg/2006/20060224/default.htm>.