

FINANCIAL SERVICES ALERT

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DEVELOPMENTS OF NOTE

Treasury Releases Details on Public-Private Investment Program Targeted at Troubled Assets

The Treasury announced further details on its Public-Private Investment Program (“PPIP”), which is a component of the Financial Stability Plan. The PPIP directly targets “legacy assets” - loans and mortgage-backed securities originated prior to 2009 which have fallen into distress following the collapse of real estate prices. The Treasury indicated that though the program initially targets real estate-related assets, it may evolve, based on market demand, to include other asset classes.

To fund the PPIP, a series of Public Private Investment Funds (PPIFs) will be formed to invest in both legacy loans and legacy securities. The Treasury has initially devoted \$75 to \$100 billion of TARP funds to the PPIP, which, when combined with private capital and several leverage mechanisms discussed below, is hoped to generate at least \$500 billion in purchasing power that may be expanded to as much as \$1 trillion. The Treasury anticipates that its initial investment in the PPIP will be evenly split between the Legacy Loan Program and the Legacy Securities Program. The Treasury stated that passive private investors in the PPIP will not be subject to executive compensation restrictions.

The Legacy Loan Program. The Legacy Loan Program focuses on real estate loans banks currently hold on their balance sheets. It is intended to attract private capital to purchase eligible legacy loans from participating banks through the provision of FDIC debt guarantees and Treasury equity co-investment. Eligible banks include any insured U.S. bank or U.S. savings association. Banks or savings associations owned or controlled by a foreign bank or company are not eligible. Private investors may not participate in any PPIF that purchases assets from sellers that are affiliates of the private investor or represent 10% or more of the aggregate private capital in the PPIF. The exact requirements and structure of the Legacy Loans Program will be subject to notice and comment rulemaking.

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Sale of Assets. To start the process, interested banks should work with their primary banking regulator to identify and evaluate eligible assets for sale under the PPIP and the corresponding financial impact on the bank from the sale of such assets. After identifying a pool of assets to sell, the bank should contact the FDIC to express an interest in participating in the Legacy Loan Program. Assets eligible for purchase ultimately will be determined by the participating banking organizations, including the primary banking regulators, the FDIC, and the Treasury. The FDIC will employ contractors to analyze the pools and will determine the level of non-recourse debt guaranteed by the FDIC to be issued by the PPIF. This will not exceed, and may be less than, a 6-to-1 debt-to-equity ratio (e.g., the FDIC will guarantee up to \$6 of debt issued by the PPIF for every \$1 of capital invested in the PPIF by the Treasury and private investors). An eligible pool of loans, with committed financing, will then be auctioned by the FDIC to qualified bidders. Private investors will bid for the opportunity to contribute 50% of the equity for the PPIF with the Treasury contributing the remainder. The winning bid for this equity stake together with the amount of debt the FDIC is willing to guarantee (based on a predetermined debt-to-equity ratio) will define the price offered to the selling bank. The bank would then decide whether to accept the offer price. The price paid to the bank will be in the form of cash or cash and FDIC-guaranteed debt.

Management of Assets. Once the initial transaction has been completed, the private capital partners will control and manage the assets until final liquidation, subject to strict oversight from the FDIC. The FDIC will play an ongoing reporting, oversight and accounting role on behalf of the FDIC and Treasury.

FDIC-Guaranteed Debt. As discussed above, the FDIC will guarantee non-recourse debt issued by the PPIFs. A fee will be assessed on the debt guaranteed by the FDIC under the PPIP, a portion of which will be allocated to the Deposit Insurance Fund. The FDIC has indicated that the non-recourse guaranteed debt will initially be placed with the participating banks, possibly as a portion of the purchase price for the legacy loans, and that the banks will be able to resell such guaranteed debt at their discretion.

Example. The following sample transaction illustrates the PPIP process for legacy loans:

Step 1: A bank with a pool of residential mortgages with \$100 face value that it is seeking to divest approaches the FDIC.

Step 2: The FDIC determines, according to the above process, that for this pool the agency is willing to leverage the pool at a 6-to-1 debt-to-equity ratio.

Step 3: The pool is then auctioned by the FDIC, with several private sector bidders submitting bids. The highest bid from the private sector – for example, \$84 – is the winner and forms a Public-Private Investment Fund to purchase the pool of mortgages.

Step 4: Of this \$84 purchase price, the FDIC provides guarantees for \$72 of PPIF debt, leaving \$12 of equity (and allowing the FDIC to meet its 6-to-1 debt to equity ratio). In this case, some or all of the \$72 of FDIC-guaranteed debt may be issued directly to the seller as part of the purchase price.

Step 5: The Treasury then provides 50% of the equity funding required on a side-by-side basis with the investor. In this case, the Treasury invests approximately \$6, with the private investor contributing \$6.

Step 6: The private investor then manages the servicing of the asset pool and the timing of its disposition on an ongoing basis – using asset managers approved and subject to oversight by the FDIC.

The Legacy Securities Program. The Legacy Securities Program consists of two related parts designed to draw private capital into these markets by providing debt financing from the FRB under an expansion of the Term Asset-Backed Securities Loan Facility (“TALF”) and through matching private capital raised for dedicated funds targeting legacy securities.

Expansion of TALF. Through the expansion of the TALF, non-recourse loans will be made available to investors to fund purchases of legacy securitization assets. In addition to the current eligible assets under the TALF (asset backed securities relating to auto loans, student loans, credit card loans, equipment loans, floorplan loans, small business loans fully guaranteed as to principal and interest by the U.S. Small Business Association, or receivables related to residential mortgage servicing advances) eligible assets are expected to expand to include certain non-agency residential mortgage-backed securities (“RMBS”) that were originally rated AAA, and outstanding commercial mortgage-backed securities (“CMBS”) and asset-backed securities that are rated AAA. Borrowers will need to meet certain eligibility criteria. Haircuts will be determined at a later date and will reflect the risk of the assets provided as collateral. Lending rates, minimum loan sizes, and loan durations have not yet been determined

Legacy Securities PPIFs. The Treasury also announced a program to partner with private fund managers to support the market for legacy securities, initially by targeting non-agency RMBS and CMBS originated prior to 2009 with a AAA rating at origination, which are similar to the asset classes targeted by the expanded TALF program discussed above. The loans and other assets underlying these eligible assets must be situated predominantly in the United States, which limitation is subject to further clarification by the Treasury. Such eligible assets will be purchased solely from financial institutions from which the Treasury may purchase assets under the Emergency Economic Stabilization Act of 2008, which includes U.S. banks, savings associations, credit unions, securities broker-dealers, and insurance companies.

Under this program, private investment managers will have the opportunity to apply for qualification as a PPIF fund manager. Applicants will be pre-qualified based upon criteria that include a demonstrable historical track record in the targeted asset classes, a minimum amount of assets under management in the targeted asset classes, and detailed structural proposals for the proposed Legacy Securities PPIF. The Treasury expects to approve approximately five PPIF fund managers and may consider adding more depending on the quality of applications received. Approved PPIF fund managers will have a period of time to raise private capital to target the designated asset classes and will receive matching equity capital from the Treasury. PPIF fund managers will be required to submit a fundraising plan to include retail investors, if possible.

Investors will participate in the PPIF through an investment vehicle. Private investors may be given voluntary withdrawal rights at the level the private vehicle, subject to limitations to be agreed with the Treasury including that no private investor may have the right to voluntarily withdraw from such an investment vehicle for three years following the first investment by such vehicle. These private investment vehicles will be structured so that benefit plan investors will be eligible to participate as indirect investors in the PPIFs.

The Treasury will invest equity capital on a fully side-by-side basis with the private investors in each PPIF. Furthermore, PPIF fund managers will have the ability, to the extent their PPIF structures meet certain guidelines, to have the PPIF issue to the Treasury non-recourse senior debt in the amount of up to 50% of a PPIF's total equity capital, and the Treasury will consider requests by the PPIFs to issue non-recourse senior debt in the amount of up to 100% of a PPIF's total equity capital subject to further restrictions on asset level leverage, redemption rights, disposition priorities, and other factors the Treasury deems relevant. This senior debt will have the same duration as the underlying fund and will be repaid on a pro-rata basis as principal repayments or disposition proceeds are realized by the PPIF. These senior loans will be structurally subordinated to any financing extended by the FRB to these PPIFs via the TALF.

Example: The following sample transaction illustrates the PPIP process for legacy securities:

Step 1: The Treasury will launch the application process for managers interested in the Legacy Securities Program.

Step 2: A fund manager submits a proposal and is pre-qualified to raise private capital to participate in joint investment programs with the Treasury.

Step 3: The Treasury agrees to provide a one-for-one match for every dollar of private capital that the fund manager raises and fund-level leverage for the proposed PPIF.

Step 4: The fund manager commences the sales process for the PPIF and is able to raise \$100 of private capital for the PPIF. The Treasury provides \$100 equity co-investment on a side-by-side basis with private capital and provides a \$100 loan to the PPIF. The Treasury will also consider requests from the fund manager for an additional loan of up to \$100 to the PPIF.

Step 5: As a result, the fund manager has \$300 (or, in some cases, up to \$400) in total capital and commences a purchase program for targeted securities.

Step 6: The fund manager has full discretion in investment decisions, although it will predominately follow a long-term buy-and-hold strategy. The PPIF, if the fund manager so determines, would also be eligible to take advantage of any expansion of the TALF program for legacy securities when such expansion occurs.

FASB Proposals Offer New Guidance on Distressed Sales and Impaired Assets

The Financial Accounting Standards Board (the "FASB") issued two proposals: (the "Proposals") – Proposed FASB Position FAS 157-e ("Proposed FAS 157-e") and Proposed FASB Position FAS 115-a, FAS124-a and EITF 99-20-b ("Proposed FAS 115-a"). The FASB has adopted the Proposals on an interim basis effective March 15, 2009, is accepting comments on the Proposals until Wednesday, April 1, 2009, and the Board of the FASB intends to evaluate all comments at its April 2, 2009 meeting.

FASB Statement 157 generally establishes a single definition for "fair value" and a framework for measuring fair value in accordance with GAAP. It also expands the disclosure about a reporting entity's fair value measurements. However, Statement 157 contemplates an orderly transaction between market participants, not a distressed market.

In the current market, many reporting entities, including many mutual funds and other collective investment vehicles, have had difficulty applying Statement 157 to structured products and other securities that no longer are traded in functioning markets or are traded only infrequently. The Proposals are intended to provide reporting entities with greater guidance relating to how they should value a financial asset when the market for that financial asset is inactive or the market prices for the financial asset are products of distressed sales, as well as how they are to reflect unearned losses relating to impaired securities in their earnings.

Proposed FAS 157-e. Proposed FAS 157-e is intended to clarify how a reporting entity determines whether the market for a financial asset is or is not active and thus, whether a sale of that asset is a distressed sale. A reporting entity generally would look to a number of indicators to determine whether the market for the financial assets is inactive. Those indicators include: (a) a dearth of recent transactions; (b) price quotations that are based on outdated information; (c) price quotations that vary substantially either over time or among market makers; (d) indexes that were highly correlated with the fair values of the assets that no longer appear to be highly correlated; (e) liquidity risk premiums that seem abnormal; (f) bid-ask spreads that seem abnormally wide; and (g) little public information on the sale. If a reporting entity determines based on those indicators that the market for the assets is not active, Proposed FAS 157-e states that it must presume that the sale is a distressed sale unless there is evidence that there (x) was sufficient time before the sale to allow for the usual and customary marketing activities for the asset and (y) were multiple bidders for the asset. If one or both of these elements is missing, Proposed FAS 157-e states that the reporting entity should conclude that the quoted price is associated with a distressed sale. Even if both of the factors are present, Proposed FAS 157-e states that the reporting entity should determine whether to consider other factors and adjust the quoted price accordingly. If a reporting entity determines that a quoted price is associated with a distressed sale, Proposed FAS 157-e requires the reporting entity to use a valuation technique other than one that uses quoted prices, that is, a fair value.

Proposed FAS 115-a. Proposed FAS 115-a is intended to clarify when a reporting entity must realize the unrealized loss on an impaired security, that is, a security with a fair value that is less than its cost, other than a security that is temporarily impaired. Currently, other-than-temporary impairments are recognized entirely in earnings. Proposed FAS 115-a would allow a reporting entity that does not have a current intent to sell a security and is more likely than not to have to sell the security before recovery (e.g., at the maturity date), to separate credit-related losses, that is, those losses as a result of impaired cash flows, from market-related losses, and then reflect only credit-related losses in earnings. Proposed FAS 115-a also would impose additional disclosure obligations relating to credit- and market-based losses.

Documentation Issues and Risks in Purchasing Residential Mortgage Loans

The March 3, 2009 Alert, *Buyer Beware: Risks and Considerations in Purchasing Residential Mortgage Loans*, discussed the legal risks and considerations associated with purchasing residential mortgage loans. This Article is intended to complement that discussion and focuses specifically on documentation risks in purchasing residential mortgage loans.

One issue that has become an increasing focus of litigation between residential mortgage lenders and borrowers is the adequacy of the “paper trail” of mortgage loan securitizations.

See, e.g., “What Got Lost in the Loan Pool,” New York Times, March 1, 2009; “New Foreclosure Defense: Prove I Owe You,” Chicago Tribune, Feb. 22, 2009. Consumer lawyers around the country have sought to capitalize on the inability of some mortgage servicers and foreclosure counsel to adequately “prove up” the mortgage loan documentation to prevent or delay foreclosure of defaulted loans. Some courts have gone so far as to dismiss foreclosure proceedings on grounds of lack of standing based on the failure of mortgage lenders to provide satisfactory proof of ownership of mortgages. See, e.g., *In re Foreclosure Cases*, 2007 WL 4589765 (S.D. Ohio).

The principal points of contention have been, first, whether possession of the borrower’s original promissory note is a prerequisite to exercise of foreclosure remedies; and, second, whether the foreclosing creditor must show a complete “chain of title” tracing assignment of the mortgage from the loan originator or other party named in the mortgage.

When a securitized mortgage loan goes into default, the loan servicer typically makes a referral to foreclosure counsel to arrange to sell the property at a public auction sale. The loan servicer will ordinarily have a copy of the originator’s loan file, but will not normally have possession of the borrower’s original Note, which is in the custody of a Trustee or Custodian under the Pooling and Servicing Agreement governing the loan pool the borrower’s loan is in.

Increasingly, at the urging of debtors and debtor’s counsel, state courts and in particular bankruptcy courts presented with motions for relief from the automatic stay to foreclose defaulted residential mortgage loans are requiring creditors to produce original Notes. When the foreclosure is sought to be conducted in the name of the trustee of a securitization trust, courts have also required proof that the borrower’s loan is in the pool. Although the Pooling and Servicing Agreement for REMIC qualified-trusts should be available on the SEC’s EDGAR Website, the mortgage loan schedule identifying the loans in the pool may not be a matter of public record, and thus a paper or electronic copy may need to be obtained and authenticated.

A related issue concerns who is entitled to enforce the Note. It has been held that “[i]f a loan has been securitized, the real party in interest is the trustee of the securitization trust, not the servicing agent.” *In re Hwang*, 396 B.R. 757, 767 (Bankr. C.D. Cal. 2008). Enforcement and foreclosure proceedings are often brought by the loan servicer, sometimes in its own name and sometimes in the name of its principal pursuant to a power of attorney. Any claimant who is not the “holder” of the Note within the meaning of the Uniform Commercial Code and in actual physical possession of the Note may find its standing challenged by borrowers and courts.

The other principal line of attack by borrowers and their counsel concerns the validity of written assignments of mortgages. A mortgage is normally recorded in public land records at the time of origination to perfect the lien and establish its priority. Most purchase money mortgages are first mortgage liens, and many home equity loans are secured by a second mortgage lien. A mortgage can be assigned, and typically is assigned any time the underlying Note is transferred, which occurs when it is negotiated. There is generally no requirement that a mortgage assignment be recorded in public land records to be valid. The custom and practice in the residential mortgage loan industry has been that mortgage assignments are often not recorded at the time the loan is securitized. Because some bankruptcy courts have dismissed stay relief motions filed before recording of an

assignment, the practice has for the most part been to record an assignment when the mortgage goes into default and resort is required to the collateral.

Another complication concerns the role of MERS-- the Mortgage Electronic Registration System, Inc. MERS was established to maintain an electronic off-record mortgage registry, thus eliminating the need for filings in the public land records whenever a mortgage changes hands. To avail itself of the MERS system, a lender can assign the mortgage to MERS, or at closing can direct the borrower to grant the mortgage to MERS as nominee. Courts have for the most part recognized the authority of MERS to foreclose mortgages where it is the record holder, albeit as nominee, but have differed on whether foreclosure can be conducted in the name of the beneficial holder of the mortgage or in the name of the loan servicer without an executed assignment of the MERS mortgage. *See, e.g., MERS v. Reveredo*, 955 So.2d 33, 34 (Fla. App. 2007) (“To the extent that courts have encountered difficulties with the question, and have even ruled to the contrary to our conclusion, the problem arises from the difficulty of attempting to shoehorn a modern innovative instrument of commerce into nomenclature and legal categories which stem essentially from the medieval English land law. . . . Because, however, it is apparent – and we so hold – that no substantive rights, obligations or defenses are affected by use of the MERS device, there is no reason why mere form should overcome the salutary substance of permitting the use of this commercially effective means of business.”); *MERSCORP v. Romaine*, 8 N.Y.3d 90, 861 N.E.2d 81 (2006) (New York Court of Appeals held that County Clerks must record mortgages and assignments naming MERS as nominee).

Investors considering the purchase of residential mortgage loans should include on their diligence checklists verifying the mortgage loan documentation to ensure they will be in a position to enforce the Note and realize on the mortgage if necessary. This entails making sure there is a proper negotiation of all Notes in accordance with UCC requirements, obtaining physical custody of the original Notes, and obtaining written assignments of mortgages in recordable form.

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FRB Delays Effective Date of Rule Limiting BHCs' Risk-Based Capital Calculations

The FRB issued a final rule (the “Rule”) delaying from March 31, 2009 until March 31, 2011, the effective date of new limits on bank holding company risk-based capital calculations. The FRB said the effective date of the Rule is being delayed because of the continuing stress in the financial markets and “to promote financial stability in the financial markets and the banking industry as a whole”.

Upon its effectiveness in 2011, the Rule will:

- (1) limit the aggregate amount of cumulative perpetual preferred stock, trust preferred securities and minority interests in consolidated subsidiaries (“restricted core capital elements”) that are includable in a bank holding company’s Tier 1 capital;

- (2) require banking holding companies to deduct goodwill, less any associated deferred tax liability, from the sum of its core capital elements in calculating the amount of its restricted core capital elements that may be included in Tier 1 capital; and
- (3) further limit the amount of restricted core capital elements that internationally active bank holding companies may include in their Tier 1 capital.

Because of the delay in the effectiveness of the Rule, until March 31, 2011 all bank holding companies may continue to hold cumulative perpetual preferred stock and trust preferred securities in their Tier 1 capital that equal in the aggregate up to 25% of the bank holding company's total core capital elements.

FDIC Extends the Debt Guarantee Component of the Temporary Liquidity Guarantee Program

The FDIC extended the debt guarantee portion of the Temporary Liquidity Guarantee Program ("TLGP") from June 30, 2009 through October 31, 2009. For further discussion of the TLGP, please see the March 10, 2009, February 17, 2009, November 25, 2008, and October 28, 2008 *Alerts*. With the extension, all insured depository institutions and those additional participants, such as holding companies, that have actively participated in the debt guarantee portion of the TLGP (by issuing guaranteed debt before April 1, 2009) may continue to issue guaranteed debt through October 31, 2009, without application. Participants that are not insured depository institutions and that have not issued FDIC-guaranteed debt before April 1, 2009 must apply by June 30, 2009, if they wish to issue guaranteed debt after that date. The guarantee on debt issued before April 1, 2009, will expire no later than June 30, 2012. The guarantee on debt issued on or after April 1, 2009, will expire no later than December 31, 2012.

The FDIC is also imposing surcharges on guaranteed debt that has a maturity of one year or more and is issued on or after April 1, 2009. For guaranteed debt that is issued by June 30, 2009, and matures by June 30, 2012, the surcharge will be 10 basis points (on an annualized basis) for an insured depository institution and 20 basis points (on an annualized basis) for all others. For all other guaranteed debt that utilizes the extension (either through a maturity after June 30, 2012, or through issuance after June 30, 2009), the surcharge will be 25 basis points (annualized) for an insured depository institution and 50 basis points (annualized) for all others. These surcharges will be in addition to current fees for guaranteed debt (100 basis points for debt with a maturity of one year or more, plus a 10 basis point surcharge for debt of entities which are not insured depositories, such as holding companies) and deposited into the Deposit Insurance Fund instead of being set aside to cover potential TLGP losses.

A participating entity that has paid the nonrefundable fee to issue non-guaranteed debt with a maturity after June 30, 2012, may apply to issue shorter-term non-guaranteed debt after June 30, 2009. Any other participating entity that wishes to issue any non-guaranteed debt (regardless of maturity) after June 30, 2009, must also apply to the FDIC.

The FDIC also issued Financial Institution Letter 15-2009, which revises the reporting requirements for the TLGP Debt Guarantee Program. Under the revised requirements, participating banking organizations that have not issued guaranteed debt at any time since the inception of the TLGP are no longer required to submit monthly reports of outstanding FDIC-guaranteed debt. Participating banking organizations issuing guaranteed debt continue to be required to register the issuance through FDICconnect within five calendar

days of the issuance date. Thirty days after the end of the month, all issuers of guaranteed debt since the inception of the program will be required to report the total amount of all outstanding FDIC-guaranteed debt, irrespective of the amount matured or still outstanding on the reporting date.

FINRA Identifies 2009 Broker-Dealer Examination Priorities

FINRA, in a letter to all FINRA member firms, highlighted new and existing areas of particular significance to its 2009 examination program. FINRA's 2009 examination priorities are as follows:

- (1) FTC's Red Flags Rule, which is effective May 1, 2009 and requires firms to maintain a written identity theft prevention program.
- (2) Alternative investments, such as high-yield bonds and bond funds, structured products, alternatives to cash holdings and other non-conventional investments, particularly:
 - Whether firms are adequately performing the required customer-specific suitability analysis; and
 - Whether sales materials and oral presentations are fair and balanced and include a discussion of risks associated with the investment.
- (3) Retail foreign currency exchange activities.
- (4) Supervision is a core element of all FINRA examinations. Specifically, FINRA noted that it will focus on the following:
 - Existence of comprehensive supervisory systems, policies and procedures;
 - Extent to which firms establish, maintain and administer their supervisory systems;
 - Firms' ongoing obligation to test and verify their supervisory procedures; and
 - Existence of a robust inspection program for both branch and non-branch locations, including close review of private securities transactions and outside business activities.
- (5) Sales practices with respect to senior investors and baby boomers.
- (6) Anti-money laundering compliance programs, specifically whether a firm's procedures are appropriately tailored to its business model, risk profile and volume of transactions.
- (7) Obligations under the Foreign Corrupt Practices Act, including maintenance of accurate books and records and adequate internal controls.
- (8) Unregistered resales of restricted securities, particularly a firm's:
 - Due diligence with respect to schemes involving low-priced securities or penny stocks; and

- Due diligence toward and recognition of red flags that may have triggered suspicious activity reporting requirements under the Bank Secrecy Act.
- (9) Adequate supervision of the sale deferred variable annuity products pursuant to NASD Conduct Rule 2821.
 - (10) Sufficiency of IT security procedures to deter security breaches, hacking, cyber attacks, account intrusions and other security threats.
 - (11) For firms that outsource key operational functions, whether they:
 - Perform the necessary due diligence and counterparty risk assessment when outsourcing those functions; and
 - Establish controls and procedures to ensure that vendors are fulfilling their duties responsibly and in compliance with applicable rules and service agreements.
 - (12) Adequacy of controls related to material, non-public information, particularly:
 - How firms tailor their information barrier procedures to their business activities and organizational structure; and
 - How firms identify information to be protected.
 - (13) Adequacy of procedures in place to comply with the customer protection rules, including correctly computing the reserve formula pursuant to Rule 15c3-3 of the Securities Exchange Act of 1934 (the “Exchange Act”) and reducing customer fully paid and excess margin securities to possession or control.
 - (14) Disclosure to customers regarding excess SIPC protection, particularly if a firm has made alternative arrangements for excess SIPC coverage.
 - (15) Controls for independently valuing inventory and collateral positions, particularly less liquid and more complex positions.
 - (16) Evaluation of counterparty credit risk.
 - (17) Accurate recording of bona fide intercompany transactions and reconciliation of intercompany accounts.
 - (18) Prompt establishment and reconciliation of suspense accounts.
 - (19) Bank sweep programs, particularly:
 - Disclosures made to customers with respect to FDIC and SIPC protections;
 - Firms’ methodology for determining interest rates on the balances swept; and
 - Disclosure of any compensation the broker-dealer receives arising from a bank sweep arrangement.
 - (20) For firms that use customer fully paid securities for lending programs:
 - Whether they record those transactions on their books and records;
 - Whether they accurately disclose those transactions to customers; and

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- The nature of any rebates paid to customers.

- (21) The sale of equity securities, particularly related to the quality of a firm's supervision and written supervisory procedures to ensure compliance with Reg SHO Rule 240T and Rule 10b-21 of the Exchange Act.
- (22) Obligations not to inappropriately circulate or disseminate any information that might reasonably be expected to influence the market price of certain securities.
- (23) Controls related to the order-entry process, particularly whether a firm's internal controls and processes adequately ensure that orders are entered and transmitted accurately.
- (24) Internal controls, procedures and surveillance practices related to the market close, particularly with regard to marking-the-close issues to ensure that potential misconduct is identified and reviewed in a timely manner.
- (25) Transaction reporting, including the accuracy of the transaction information reported by firms or on their behalf.
- (26) Proper processing of daily OATS submissions pursuant to recent enhancements to the OATS system.

OCC Issues Interpretive Letter Permitting National Banks to Engage in Derivative Transactions on Longevity Indices

The OCC issued an interpretive letter ("Letter #1110") permitting national banks to engage in customer-driven derivative transactions on longevity indices. The proposed longevity index derivatives could be used by customers to take or hedge exposure to the longevity and mortality of a certain population, and could assist customers such as pension plans in managing financial risks associated with longevity risk. The OCC said that Letter #1110 follows long-standing OCC precedent permitting national banks to act as financial intermediaries in a variety of derivative transactions – including options, forwards and swaps involving equity indices, credit derivative indices and inflation indices, among others – where the transactions are perfectly matched and settle in cash.

Letter #1110 states that a national bank, by acting as a middleman in arranging the exchange of payments between counterparties (which may include an affiliate of the bank), is not providing insurance in a state, as generally prohibited by the Gramm-Leach-Bliley Act of 1999; however, national banks may not enter into longevity index derivative transactions with an insurance company referencing losses on the insurance company's own policies.

A national bank wishing to engage in longevity index derivative transactions must notify its examiner-in-charge and receive written notification of the examiner's supervisory no-objection, which will be based on an evaluation of the bank's ability to conduct the activity in a safe and sound manner in light of the bank's risk measurement and management systems and controls. In addition, banks must maintain compliance with the requirements of Section 23A and 23B and the FRB's Regulation W with respect to transactions between affiliates.

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