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# FINANCIAL SERVICES ALERT

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## DEVELOPMENTS OF NOTE

### Eighth Circuit Reverses District Court Dismissal of Mutual Fund Excessive Fee Suit

The U.S. Court of Appeals for the Eighth Circuit (the "Appeals Court") reversed a decision by the District Court for the District of Minnesota (the "District Court") in which the District Court dismissed plaintiffs' claims in a shareholder suit brought against an investment adviser (the "Adviser") alleging that the fees the Adviser charged 11 mutual funds (the "Funds") violated Section 36(b) of the Investment Company Act of 1940, as amended (the "1940 Act"). The plaintiffs claimed that the Adviser violated its statutory fiduciary duty under Section 36(b) by misleading the Funds' board (the "Board") during the annual approval of the Funds' advisory fees and by demanding excessive fees. Following limited discovery, the District Court granted the Adviser's motion for summary judgment based on an analysis of the factors cited in the *Gartenberg v. Merrill Lynch Asset Mgmt., Inc.*, 694 F.2d 923 (2d Cir. 1982) ("*Gartenberg*"). Earlier in the proceedings, the District Court determined that the period for which damages in the suit would be calculated was restricted to the year preceding the date the suit was filed.

*Harris Associates*. As the Appeals Court noted in its opinion, the U.S. Supreme Court will review the decision in *Jones v. Harris Associates,* 537 F.3d 728 (7th Cir. 2008) ("*Harris Associates*") (*see* the March 10, 2009 *Alert*), a Section 36(b) case that expressly rejected the *Gartenberg* standard. Oral argument in *Harris Associates* is scheduled for the October 2009 term. The Appeals Court noted that the some observers have suggested that the Supreme Court may establish a new standard of review for Section 36(b) cases.

*Board Approval of the Advisory Fees*. The Appeals Court noted that the Board had access to a wide variety of information during its review of the Adviser's fees, including reports on

the services provided to the Funds, the personnel providing those services, the Funds' investment performance, comparative data from Lipper, Inc. on advisory fees charged the Funds and other funds in the industry, and the Adviser's profits from its relationship with the Funds. The Appeals Court concluded that the Adviser and the Board focused primarily on the issue of how the Funds' fees compared to those of their mutual fund peer group. During the approval process, the Board became aware that the fees charged the Adviser's mutual fund clients and those charged its institutional clients differed, with the institutional clients being charged lower fees, in some cases half the fee charged Funds with similar mandates. The Board requested a report from the Adviser explaining the similarities and differences between the two types of accounts (the "Report"), which the Adviser subsequently produced.

*Plaintiffs' Arguments*. The plaintiffs argued that (1) the advisory contract review was inherently flawed because it was based not on the Adviser's costs and profits but on external factors, in particular, fee arrangements for similar mutual funds, (2) the Adviser provided comparable advisory services to its institutional clients at a substantially lower fee than it charged the Funds, and (3) the Adviser misled the Board about arrangements with institutional clients to prevent the Board from questioning the higher fees charged the Funds. The plaintiffs' expert testified that the Report was improperly designed to make the fee discrepancy between the Funds and institutional accounts seem smaller and more justifiable than it actually was. Expert testimony for the plaintiffs also indicated that the Adviser's services provided to the Funds were similar, if not identical, to the services provided to the Adviser's institutional clients. Expert testimony for the Adviser, on the other hand, contended that the difference in fees was warranted by additional services provided to the Funds, such as compliance with legal and regulatory requirements, shareholder communication and more frequent Board support. The Adviser also pointed out that fee discrepancies between mutual funds and institutional accounts managed by the same investment adviser were common throughout the industry. Although the Adviser objected to the plaintiffs' characterization of the Report as inaccurate and misleading, the Adviser's primary argument was that the contents of the Report were irrelevant because an adviser cannot be liable for a breach of fiduciary duty under Section 36(b) as long as its fees are roughly in line with industry norms.

*The Appeals Court's Analysis*. The Appeals Court indicated that the appropriate standard for decisions in Section 36(b) cases encompassed both the multi-factor *Gartenberg* test and the fiduciary conduct standard articulated by the Seventh Circuit in *Harris Associates*. The Appeals Court characterized the latter as deriving from the plain language of Section 36(b) and imposing on advisers a duty to be honest and transparent throughout the fee approval process. The Appeals Court indicated that its conclusion was consistent with *Gartenberg*, which it viewed as addressing only the question of whether the advisory fee itself was so high that it violated Section 36(b). The Appeals Court also noted that *Gartenberg* did not address, much less overrule, an earlier Section 36(b) case in the Second Circuit, *Galfand v. Chestnutt*, 545 F.2d 807 (2d Cir. 1976), which found a Section 36(b) violation when an adviser obtained a favorable change in a fund's advisory fee schedule without making full disclosure to the fund's board.

Applying these standards, the Appeals Court found that the District Court erred in holding that no Section 36(b) violation occurred simply because the fees charged the Funds satisfied the *Gartenberg* multi-factor test. Although the Appeals Court viewed the District Court as properly applying the *Gartenberg* factors to determine whether the fee itself constituted a breach of fiduciary duty, the District Court should not have rejected a comparison between

the fees charged the Funds and the fees charged the Adviser's institutional clients. The Appeals Court noted that the District Court had based its decision to reject the fee comparison on dicta in *Gartenberg* where the court had deemed inappropriate a comparison of the advisory fees for fundamentally different investment vehicles, in that case, money market funds and equity pension funds. The Appeals Court found that in this case, however, a comparison was not necessarily irrelevant given the greater similarity between the funds and accounts being compared, and in fact, the argument for comparing mutual fund advisory fees with fees charged to two institutional accounts was particularly strong because the investment advice may have been essentially the same for both accounts. Given the conflicting expert testimony on the accuracy and veracity of the Report and the Report's relevance, the Appeals Court held that the District Court should have explored the disputed issues of material fact concerning the similarities and differences between the fees charged the Funds and the Adviser's institutional accounts. Similarly, the Appeals Court found that the District Court should have determined whether the Adviser purposely "omitted, disguised, or obfuscated" information that it presented to the Board about the fee discrepancy between the Funds and the Adviser's institutional accounts, noting that there were material questions of fact on this issue as well.

The Appeals Court cautioned that the "candid, transparent negotiation" of mutual fund fees does not require discussion of every issue that plaintiffs might find relevant and does not require that a fund adviser adopt a particular negotiation strategy with fund boards. The Appeals Court went on to say that while basing mutual fund fees on an industry median will not provide safe harbor protection from Section 36(b) liability, a negotiation strategy similar to that employed by the Adviser was not necessarily suspect, and that "an effort to meet or surpass the value offered by one's primary competitors is a common business strategy, and there is no reason to assume it indicates bad faith."

*Statutory Damages*. Relying on the plain language of Section 36(b), which provides that "[n]o award of damages shall be recoverable for any period prior to one year before the action was instituted," the Appeals Court held that if the plaintiffs have continued to suffer damage during the litigation, both the language of the statute and the interest of judicial economy suggest that damages suffered after a plaintiff filed suit should be available in that action (and not be excluded for periods subsequent to the filing of the suit as contended by the Adviser and ruled by the District Court).

* * *

The Appeals Court remanded the case to the District Court for further proceedings not inconsistent with the Appeals Court's views.

## Basel Committee Responses to Financial Crisis

Nout Wellink, the Chairman of the Basel Committee on Banking Supervision (the "Basel Committee") delivered a speech regarding the initiatives of the Basel Committee in response to the financial crisis. His speech focused on four areas: regulatory capital, liquidity, risk management and supervision, and transparency. He also stated that he welcomed the actions of the G-20 and other bodies, such as the Financial Stability Board to regulate bank-like activities engaged in by non-banks to ensure a comprehensive regulatory response to the current crisis.

*Regulatory Capital*. Chairman Wellink emphasized that to prevent future crises of this magnitude the level of capital in the banking system must be strengthened. In fact, he wishes to require capital levels above those mandated by either the Basel I or Basel II frameworks, although he does not want to increase the requirements immediately and thereby deepen the current credit crisis. Of particular concern, Chairman Wellink stated that the Basel Committee must enhance the Basel II framework so that exposures not adequately captured under the current framework, including from securitization activities and trading book exposures, will be more comprehensively covered in the future. Moreover, he stated that the highest form of Tier 1 capital must be simplified, with standards that are both transparent and global. To dampen procyclicality, among other things the Basel Committee will be developing proposals to build countercyclical buffers into the capital requirements, so as to ensure that during robust periods adequate reserves are developed to blunt the impact of stressful times. Finally, and perhaps must significantly with respect to capital, the Chairman stated that the Basel II risk capital framework needs to be supplemented by a "non-risk based supplemental measure". Indicating that it will be like the current leverage ratio in the US, but perhaps even broader, Chairman Wellink stated that this non-risk based measure "must be simple and transparent, and it must address issues related to accounting differences and off-balance sheet exposures, among others."

*Liquidity*. As to liquidity initiatives, Chairman Wellink cited the publication last September by the Basel Committee of its "Principles of Sound Liquidity Risk Management and Supervision." He stated that the next step is to develop a framework to monitor implementation of those principles, including by "developing benchmarks, tools and metrics that supervisors can use to promote more consistent liquidity standards for cross-border banks."

*Risk Management and Supervision*. Chairman Wellink also discussed initiatives the Basel Committee is pursuing to improve risk management and supervision at banks. He stated that such improvements largely would be accomplished by the regulators raising the bar of oversight under Pillar 2 (Supervisory Review Process) of Basel II. He specified that the Basel Committee would look at ways of strengthening "firm-wide governance and risk management; capturing the risk of off-balance sheet exposures and securitization activities; more effectively managing risk concentrations; and providing incentives to better manage risks and returns over the long-term, including compensation practices." Chairman Wellink also noted that the Basel Committee also was examining a more "macroprudential approach" to supervision, focusing not just on individual banks but on broader financial stability objectives. See the January 13, 2009 *Alert*.

*Transparency*. As to transparency, Chairman Wellink focused on Pillar 3, market discipline, of Basel II. He stated that the Basel Committee was working on enhanced disclosures relating to securitization, off-balance-sheet exposures, and trading activities. He hoped these measures would prevent future crises based on a lack of investor knowledge about the true strength of a bank's balance sheet.

## Big Bang Protocol for Credit Derivatives Becomes Effective

April 8, 2009 was the effective date for the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement CDS Protocol, also known as the "Big Bang Protocol" (the "Protocol"). The Protocol was open for adherence by parties to existing credit default swaps from March 12, 2009. Signing on to the Protocol permitted parties to incorporate the 2009 ISDA Credit Derivatives Determinations Committees and Auction Settlement

Supplement to the Definitions (referred to as the "March 2009 Supplement," which supplements the 2003 ISDA Credit Derivatives Definitions (referred to as the "Definitions")) and to adopt credit event and succession event backstop dates into their existing transactions and credit derivative transactions (also referred to as credit default swaps or CDS) that are new or novated between April 8, 2009 and January 31, 2011. The International Swaps and Derivatives Association, Inc. ("ISDA") announced that as of April 8, 2009, more than 2,000 market participants agreed to adhere to the Protocol.

The Protocol introduces three components to the CDS market (summarized with bullets and further described below) aimed at increasing fungibility among certain credit derivatives transactions.

- A structure of five regional Credit Derivatives Determinations Committees ("DCs") comprised of dealer and buy-side representatives.
- The establishment of credit event and succession event backstop dates (60/90 days, respectively) so that different transactions will have effective credit events and succession events notwithstanding that they have different trade dates and termination dates.
- The addition of "Auction Settlement" as a settlement method in order to "hard wire" much of current practice into a consistent settlement methodology across auctions, with auction-specific terms and deliverable obligations to be among the matters determined by the DCs.

*Credit Derivatives Determinations Committees*. The March 2009 Supplement establishes five regional DCs and provides that the resolutions of the DCs are binding on all covered transactions (*i.e.*, transactions that have incorporated the March 2009 Supplement). Any ISDA member may request that a DC address a specific question with respect to covered CDS transactions or the market generally. The March 2009 Supplement sets forth timelines under which a DC must respond and resolve any question. To the extent that a DC is not able to obtain an 80% supermajority vote with respect to any issue it considers, that issue will automatically go to an external review panel consisting of individuals chosen randomly from a pool nominated by ISDA members and approved by a majority of the members of the relevant DC. ISDA will publish all resolutions and decisions by DCs on its website. The DCs' binding determinations with respect to certain conditions and events will supersede the role of a transaction's calculation agent with respect to certain terms, thus moving the CDS market toward increased standardization.

The five DCs are for the Americas, Japan, EMEA (Europe, Middle East and Africa), Asia (less Japan) and Australia-New Zealand, and each DC will resolve issues relevant to the particular credit derivatives market in its region. Each DC will consist of eight global dealer voting members, two regional dealer voting members for the relevant region, five global non-dealer (*i.e.*, buy-side) voting members and certain non-voting dealers and buy-side members as alternates. To qualify to become a member of a DC, a buy-side institution must (i) have at least US$1 billion of assets under management, (ii) have single-name CDS transaction exposure in excess of US$1 billion in notional amount, (iii) receive the approval of 1/3 of the then-current buy-side committee, and (iv) adhere to the Protocol. A non-dealer may be selected as a member of the DC non-dealer committee by providing a written summary of its experience in the credit derivatives market and a written certification of the above-mentioned criteria. For a dealer to qualify to become a member of a DC, it must

(i) serve as a participating bidder in the auctions relating to the Protocol, (ii) adhere to the Protocol and (iii) maintain certain credit default swap notional trade volumes based on Depository Trust & Clearing Corporation data.

*Credit Event and Succession Event Backstop Dates*. A Credit Event Backstop Date is 60 days prior to (i) the date of submission of a request to the DC regarding that credit event or (ii) the date of delivery of both a Credit Event Notice and, if applicable, a Notice of Publicly Available Information (each as defined in the Definitions, as amended by the March 2009 Supplement). A Succession Event Backstop Date is 90 days prior to (i) the submission date of a request to the DC regarding that succession event or (ii) the delivery date of a Succession Event Notice (as defined in the Definitions, as amended). Accordingly, a credit event occurring prior to the 60-day look-back, or a succession event occurring prior to the 90-day look-back, will have no impact on a transaction that incorporates the Definitions, as amended by the March 2009 Supplement, even if such event takes place within the term of that transaction.

Standardized look-back periods applicable to all covered CDS transactions (replacing unique periods defined by each transaction's effective date and termination date) result in a greater number of offsetting trades, facilitating compression (or "tear-ups") and increased flexibility in hedging. In consideration of this substantial change to the rights of parties to existing transactions, Credit Event and Succession Event Backstop Dates will not take effect for existing transactions until June 20, 2009 in order to allow parties to inform the DC of any relevant credit event or succession event (even if such event occurs outside the 60/90 look-back period).

*Auction Settlement*. The addition of "Auction Settlement" as a new settlement method is also referred to as "auction hardwiring." After April 8, 2009, parties to a covered transaction (*i.e.*, a credit derivative transaction that incorporates the Definitions as amended by the March 2009 Supplement) may elect to settle their transaction through a relatively standardized auction process, conducted by the applicable DC. Specific terms and deliverable obligations for an auction will be determined by the DC and published by ISDA in the form of Schedule 1 and Schedule 2 to the Credit Derivatives Auction Settlement Terms.

*Application of the Protocol*. The Protocol applies to covered index transactions, covered swaption transactions and covered non-swaption transactions, as well as covered non-auction transactions (*e.g.*, Reference Obligation only, Fixed Recovery, Preferred CDS, or Party Specified Non-Auction Transactions). Covered non-auction transactions will incorporate the March 2009 Supplement (*i.e.*, including the provisions relating to DC determinations) but will not specify Auction Settlement. The following credit derivative transactions are excluded from the scope of the Protocol and will not be amended to incorporate the provisions of the March 2009 Supplement unless the parties bilaterally agree otherwise:

- Loan only credit derivative transactions;
- Credit derivative transactions referencing U.S. municipalities;
- Credit derivative transactions referencing asset-backed securities and similar securities; and
- Index transactions entered into between two of the main dealers (listed in the Protocol) relating to trust certificates linked to any Dow Jones CDX.NA.HY Index or CDX.NA.HY Index.

Additionally, parties to any transaction may agree bilaterally that their transaction will not be covered by the Protocol Auction Settlement.

## FinCEN Issues SAR Guidance Regarding Loan Modification/Foreclosure Rescue Scams

The Financial Crimes Enforcement Network ("FinCEN") issued guidance [FIN-2009-A001] to financial institutions on filing suspicious activity reports ("SARs") regarding loan modification and foreclosure rescue scams. The FinCEN guidance noted an increasing amount of fraud relating to loan modification and foreclosure rescue scams and stated that unscrupulous persons and companies are targeting homeowners having difficulty in paying their mortgages. FinCEN also stated that the Home Affordable Refinance Program and the Home Affordable Modification Program, recently outlined by Treasury Secretary Timothy Geithner, may present an opportunity for abuse by unscrupulous persons or companies.

FinCEN noted that financial institutions may interact with loan modification and foreclosure rescue scams in two ways. First, persons or entities perpetrating scams may use the services of a financial institution to receive, deposit or transfer funds related to such scams. In this context, FinCEN reminded financial institutions that they should maintain risk-based anti-money laundering policies, procedures and processes to avoid misuse and to aid in the identification of potentially suspicious transactions. Second, financial institutions may interact with customers who are victims of loan modification or foreclosure rescue scams.

FinCEN provided a list of "red flags" to help financial institutions identify loan modification and foreclosure rescue scams. The red flags include, among others, a homeowner stating that he or she has been making payments to a party other than the mortgage holder or servicer, that he or she has hired a third party to help avoid foreclosure or help renegotiate the terms of his or her mortgage and that a third party used aggressive tactics to seek out the homeowner, that he or she paid someone to assist in obtaining help from the correct federal affordable housing program, or that he or she has been advised that there is no need to pay a mortgage because the contract is invalid.

FinCEN asked financial institutions that become aware of fraudulent activities related to loan modification or financial rescue scams to include the term "foreclosure rescue scam" in the narrative portions of all relevant SARs filed. FinCEN also requested that financial institutions include all information available for each party suspected of fraudulent activity when completing the Suspect/Subject Information Section of SARs. FinCEN clarified that the homeowner is often the victim of the scam and therefore should not be listed as a suspect, unless there is reason to believe the homeowner participated in fraudulent activity.

## Treasury Releases Capital Purchase Program Term Sheets for Mutual Holding Companies

The Treasury released three term sheets (further described below) allowing mutual bank holding companies ("Mutual BHCs") and mutual savings and loan holding companies ("Mutual SLHCs") to participate in the Capital Purchase Program ("CPP"): (i) a term sheet for Mutual BHCs and Mutual SLHCs that do not directly own and control another bank holding company ("BHC") or savings and loan holding company ("SLHC"), (ii) a term

sheet for BHCs or SLHCs that are publicly traded and are directly owned and controlled by a Mutual BHC or Mutual SLHC and (iii) a term sheet for BHCs or SLHCs that are not publicly traded but are directly owned and controlled by a Mutual BHC or Mutual SLHC. These term sheets do not allow mutual savings banks or mutual savings associations without mutual holding companies to participate in the CPP. The Treasury has not given any indication when, or if, it will release a term sheet allowing participation in the CPP by mutual savings banks and mutual savings associations. Banking organizations that are controlled by a foreign bank or company are not eligible for participation in the CPP.

*Application to Participate*. Mutual BHCs and Mutual SLHCs have until 5 p.m. Eastern Time, May 7, 2009, to apply to the CPP by submitting an application to the appropriate Federal banking agency. Applicants must apply to both the regulator of its holding company and the regulator of its largest depository institution. The appropriate Federal banking agency/ies will review the applications and forward them to the Treasury for approval. The Treasury will not release the names of applicants whose applications are denied or withdrawn, but will provide electronic reports within 48 hours detailing completed transactions, as required by the Emergency Economic Stabilization Act of 2008.

*Top-Tier Mutual Holding Company Terms*. Mutual BHCs and Mutual SLHCs that engage solely in or predominantly in activities permissible for a financial holding company and do not directly own or control a BHC or SLHC may sell subordinated debentures ("Senior Securities") to the Treasury. The aggregate principal amount of the Senior Securities must be between 1% and 3% of the risk-weighted assets of the issuing Mutual BHC or Mutual SLHC but in no event may exceed $25 billion. The Senior Securities are senior to mutual capital certificates and other capital instruments authorized by state law, but must be subordinated to senior indebtedness of the Mutual BHC or Mutual SLHC unless such senior indebtedness is specifically made *pari passu* or subordinated to the Senior Securities. The Senior Securities qualify as Tier 1 capital, have a maturity of 30 years and are freely transferable. The Senior Securities have no voting rights other than class voting rights on the issuance of equity securities which purport to rank senior to the Senior Securities, any amendment to the rights of the Senior Securities and any merger or similar transaction.

The annual interest rate on the Senior Securities will be 7.7% for five years and after the fifth anniversary the annual interest rate will increase to 13.8%. Interest may be deferred for up to 20 quarters, however any unpaid interest will accumulate and compound at the interest rate then in effect. Notwithstanding any interest deferral, if interest is not paid for six quarters, whether or not consecutive, holders of Senior Securities have the right to elect 2 directors. Mutual BHCs and Mutual SLHCs participating in the CPP are subject to certain restrictions on the payment of dividends and the repurchase and redemption of equity securities, capital certificates, other capital instrument or trust preferred securities. Many of these dividend and repurchase restrictions do not apply if the Treasury has transferred the Senior Securities to a third party. After ten years, participating Mutual BHCs and Mutual SLHCs may not pay any dividends or redeem or repurchase any equity securities, capital certificates, other capital instrument or trust preferred securities until the Senior Securities are fully redeemed.

The Treasury also will receive warrants to purchase additional Senior Securities ("Warrant Securities") in an amount equal to 5% of the Senior Securities purchased on the date of the investment, subject to certain reductions. The Treasury intends to immediately exercise the warrants. The Warrant Securities have the same rights and terms as the Senior Securities,

except that the annual interest rate is always 13.8% and they may not be redeemed until all of the Senior Securities have been redeemed.

*Public Holding Companies with a Mutual Top-Tier Parent*. Publicly traded BHCs and SLHCs that engage solely in or predominately in activities permissible for a financial holding company and are directly owned and controlled by a Mutual BHC or Mutual SLHC may sell senior preferred securities ("Senior Preferred") to the Treasury. The aggregate principal amount of the Senior Preferred must be between 1% and 3% of the risk-weighted assets of the issuing BHC or SLHC but in no event may exceed $25 billion. The Senior Preferred will rank senior to common stock and *pari passu* with existing preferred shares other than preferred shares that by their terms rank junior to existing preferred shares. The Senior Preferred qualify as Tier 1 capital, are perpetual and are freely transferable. The Senior Preferred have no voting rights other than class voting rights on the issuance of shares senior to the Senior Preferred, any amendment to the rights of the Senior Preferred, and any merger or similar transaction.

For the first five years, the Senior Preferred will pay cumulative dividends at a 5% annual rate, and after the fifth anniversary the annual rate will increase to 9%. If interest is not paid for six quarters, whether or not consecutive, holders of the Senior Preferred have the right to elect 2 directors. Dividends on other preferred shares and common shares may not be paid if the interest on the Senior Preferred is not fully paid. For the first three years, certain restrictions apply on the payment of dividends and the repurchase and redemption of equity securities, capital certificates, other capital instrument or trust preferred securities. These restrictions are less burdensome than the restrictions for Mutual BHCs and Mutual SLHCs without mid-tier BHCs or SLHCs. Many of these dividend and repurchase restrictions do not apply if the Treasury has transferred the Senior Preferred to a third party.

The Treasury also will receive immediately exercisable warrants to purchase a number of shares of common stock of the issuing BHC or SLHC having an aggregate market price equal to 15% of the Senior Preferred amount on the date of investment, subject certain reductions. The initial exercise price for the warrants, and the market price for determining the number of shares of common stock subject to the warrants, will be the market price for the common stock on the date of the Senior Preferred investment (calculated on a 20-trading day trailing average), subject to customary anti-dilution adjustments.

*Non-Public Holding Companies with a Mutual Top-Tier Parent*. BHCs and SLHCs that engage solely in or predominately in activities permissible for a financial holding company and are directly owned and controlled by a Mutual BHC or Mutual SLHC but are not publicly traded may sell preferred securities ("Preferred") to the Treasury on substantially similar terms as the Senior Preferred discussed above. Unlike the Senior Preferred, but similar to the Senior Securities, the restrictions on dividends and repurchases extend for ten years and after the tenth anniversary issuers of Preferred may not pay common dividends or redeem or repurchase any equity securities or trust preferred securities until the Preferred are redeemed in whole or transferred to third parties.

The Treasury also will receive immediately exercisable warrants to purchase, upon net settlement, a number of net shares of preferred stock of the participating holding company having an aggregate liquidation preference equal to 5% of the Preferred amount on the date of investment, subject to certain reductions. The initial exercise price for the warrants shall be $0.01 per share unless the issuer's charter requires a different amount. The Treasury intends to immediately exercise the warrants.

**GOODWIN PROCTER FINANCIAL SERVICES PRACTICE**

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*Additional Restrictions and Redemption*. Participating Mutual BHCs and Mutual SLHCs will be subject to the executive compensation, transparency, accountability and monitoring guidelines applicable to other TARP recipients. Senior Securities, Senior Preferred or Preferred may be redeemed with the approval of the appropriate Federal banking agency at 100% of the issue price plus any accrued and unpaid interest or dividends.

### FASB Formally Adopts Staff Positions on Fair Value

The Financial Accounting Standards Board ("FASB") has issued final Staff positions: FSP FAS 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly," and FSP FAS 115-2 and FAS 124-2, "Recognition and Presentation of Other-Than-Temporary Impairments." The proposed versions of those Staff positions and the FASB statements relating to their adoption were discussed in the March 24, 2009 *Alert* and April 7, 2009 *Alert*, respectively.

In addition, FASB issued another Staff position, FSP FAS 107-1 and APB 28-1, "Interim Disclosures about Fair Value of Financial Instruments," which requires publicly traded companies (which would include some banks, bank holding companies, investment advisers and investment companies) to provide certain fair value disclosures in their interim reports, not just their annual reports. This Staff position is effective for interim periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009.

## OTHER ITEM OF NOTE

### TARP Expected to be Expanded to Include Life Insurance Companies

The Treasury is expected to expand the TARP within the next few days to include life insurance companies. Only life insurance companies that own banks will qualify, and the assistance will be provided through the Capital Purchase Program. It is unclear how much money will be made available for life insurers, the Treasury reports that $130 billion in TARP funds remain. Any life insurance company participating in this program will be subject to the executive compensation restrictions that apply to all TARP recipients.

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