

FINANCIAL SERVICES ALERT

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Gregory J. Lyons

Eric R. Fischer

Jackson B.R. Galloway

Elizabeth Shea Fries

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DEVELOPMENTS OF NOTE

FRB Issues Interpretive Letters Concerning Minority Investments in Banking Institutions

When it approved GMAC LLC (“GMAC”) as a bank holding company (“BHC”) in December 2008 (the “December Order”) (see the [December 30, 2008 Alert](#)), the FRB also discussed the necessary actions by the two principal owners of GMAC, entities controlled by or affiliated with the private equity firm Cerberus Capital Management, L.P. (“Cerberus entities”), and General Motors Corporation (“GM”), to avoid the Cerberus entities or GM themselves being deemed BHCs. The FRB has issued two interpretive letters, each dated March 24, 2009, to provide further detail on the necessary actions of the Cerberus entities and GM, respectively.

Cerberus entities. The interpretive letter relating to the Cerberus entities first lists the historical factors that create a BHC status concern for them: (1) ownership of 51% of the voting interests in GMAC, (2) having 5 GMAC board members, and (3) maintaining substantial business relationships with GMAC and its subsidiaries. To address the first of these concerns, the Cerberus entities would distribute a portion of those voting interests to unaffiliated investors, such that the Cerberus entities would own less than 25% of the voting interests in GMAC, and the unaffiliated investors would each own less than 5%. In the December Order, consistent with the FRB’s 2008 Policy Statement on equity investments in banks and bank holding companies (“Policy Statement”) (see the [September 23, 2008 Alert](#)), the Cerberus entities would hold less than 15% of the voting interests and 33% of the

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total equity in GMAC. In the interpretive letter, the Cerberus entities committed to own approximately 22% of GMAC's voting interests (and no other equity), which also is consistent with the Policy Statement. Moreover, in the interpretive letter the Cerberus entities committed that the co-investors would have unencumbered rights to vote and dispose of their shares, that there would be no voting agreements, and that Cerberus would not advise co-investors regarding the voting of shares.

As to the second concern (GMAC director representation), consistent with the Policy Statement, the Cerberus entities would reduce their representation on the GMAC board to one director, and that director would not serve as Chairman of the Board or the Chairman of any committee. Any employee interlocks and advisory agreements with GMAC also would be eliminated.

Finally, as to the third concern (business relationships), the Cerberus entities would limit their business relationships with GMAC to those maintained historically (largely lending related). The Cerberus entities also agreed to enter into passivity commitments similar to those historically approved by the FRB (modified to address the Policy Statement), which were attached as exhibits to the interpretive letter.

GM. In the GM interpretive letter, the FRB addressed the additional concern that GM has controlled GMAC since the latter's formation, and GM and GMAC have been integral to each other's operations. Under analogous circumstances, the FRB has determined that the controlling company remained able to exert a controlling influence on the other even after a significant divestiture, and thus to avoid being deemed a BHC has required the controlling company to reduce its ownership below 5% of voting equity and only permitted the controlling company to maintain "minimal ongoing business relationships." 12 CFR 225.138.

To address this concern while also recognizing the "unique circumstances surrounding the proposal by GMAC" and, perhaps, the more lenient stance of the Policy Statement, the interpretive letter permits GM to reduce its holdings to less than 10% of the voting and total equity of GMAC, and to transfer the remainder of its equity interest to a trust with an independent trustee. The trustee will be required to dispose of those shares within 3 years, and will have sole discretion to vote and dispose of the shares in the interim. GM also will have to treat GMAC as an affiliate for purposes of the FRB's affiliate transaction rules until GM, either directly or as beneficiary of the trust, owns less than 10% of the voting or total equity of GMAC.

In addition, GM would surrender all of its representatives on GMAC's board of directors, although it would have a nonvoting observer. Furthermore, the contracts establishing the relationship would be amended to eliminate restrictions on GMAC engaging in business with others.

SEC Settles Enforcement Proceeding with Investment Adviser over Failure to Adhere to Advertised Due Diligence Procedures and Failure to Adequately Investigate "Red Flags" Related to Hedge Fund Recommendations

The SEC settled enforcement proceedings under the anti-fraud provisions of Section 206(2) of the Investment Advisers Act of 1940 against a registered investment adviser (the "Adviser") and its principal (together with the Adviser, the "Respondents") for failing to review and analyze a recommended family of hedge funds (the "Hedge Funds") pursuant to

due diligence procedures that the Respondents represented they would follow when evaluating, selecting and monitoring hedge fund investments (the “Procedures”). In addition, the SEC found that the Respondents subsequently failed to adequately respond to information suggesting that (a) the identity of the outside auditor to the Hedge Funds was in doubt and (b) there existed a conflict of interest between a principal of the Hedge Funds’ investment adviser and the purported outside auditor. In a separate proceeding, the SEC had already found the Hedge Funds to be fraudulent investment schemes and found the audited financial statements and the auditor opinion letters on behalf of the Hedge Funds to be falsified, costing the Respondents’ clients more than \$56 million.

Failure to Follow Advertised Procedures: From 2002 to 2005, the Adviser promoted its Procedures as the “Five Level Due Diligence Process” and routinely touted the excellence and rigor of these Procedures for assessing investments in marketing materials, its website, and in oral and written presentations. In evaluating the Hedge Funds, however, the Adviser at the principal’s direction did not perform two core elements of the Procedures: (1) a portfolio and trading analysis; and (2) a verification of the relationship between the Hedge Funds’ investment adviser and auditor.

The promotional materials circulated by the Adviser indicated that it conducted portfolio and trading analyses based on prime brokerage reports to evaluate quantitative information about a fund’s portfolio characteristics, investment and trading strategies and risk disciplines. Nevertheless, when the Hedge Funds refused to provide such information to the Adviser, the Respondents continued with their positive recommendations of the funds relying entirely on the uncorroborated representations and purported rates of return received from the Hedge Funds and their investment adviser and without disclosing to clients that Respondents had not conducted the advertised portfolio and trading analysis.

Similarly, the Adviser advertised that it verified a fund’s relationship with its independent auditor and ensured that the auditor actually performed audits of the financial statements. While the Hedge Funds’ investment adviser provided the Adviser with audited financial statements from one accounting firm and told the Adviser that more recent financial statements were to be audited by a different accounting firm, the Adviser took no steps during its initial evaluation to confirm that either accounting firm had an audit relationship with the Hedge Funds. The SEC emphasized the need for auditor verification under such circumstances where the Adviser had no previous relationship with either named auditor and none of the many other hedge funds that the Adviser recommended had used either auditor.

Accordingly, the SEC found that the Respondents breached their fiduciary duty by misrepresenting the services that they were providing and without fully disclosing material departures from the Procedures to clients.

Inadequate Response to Red Flags: The SEC found that the Adviser subsequently failed to properly follow up on inconsistent information it received concerning the Hedge Funds’ outside auditing firm. First, while the Adviser was told that a new auditing firm was hired to conduct audits in 2002 and received marketing materials to that effect, audited financial statements from 2002-2004 were signed by and on the letterhead of the Hedge Funds’ previous auditing firm. The Adviser failed to act on this information or disclose it to clients.

Second, the Adviser, through its principal, failed to adequately follow up on rumors it received that the chief operating officer/chief financial officer of the Hedge Funds' investment adviser had an economic interest in the previous auditing firm. Instead, the Adviser relied on written representations from that individual that he had severed all ties with the previous auditing firm. Despite contradictory information in its own files, the Adviser took no steps to further investigate the rumors, such as contacting the previous audit firm or conducting research on the internet or through public records. By failing to adequately respond to conflicting information that it had received, the SEC found that the Respondents had breached their fiduciary duties to their advisory clients.

Sanctions: In addition to censure and cease and desist sanctions, the Respondents were jointly and severally required to disgorge nearly \$715,000 (including interest) and pay a civil monetary penalty of \$100,000. Each Respondent also undertook to (A) adopt written policies and procedures to ensure adequate disclosures to clients and prospective clients regarding the Adviser's process for evaluating, selecting and monitoring hedge funds, and (B) mail copies of the SEC order to their existing clients and provide a copy to any new client during the succeeding two years.

FRB Releases Methodology for Capital Assistance Program Stress Test

The FRB released a detailed description of the methodology used to conduct the "stress tests" under the Capital Assistance Program ("CAP"). The CAP is the component of the Obama administration's Financial Stability Plan that allows banking organizations access to further capital investments by the Treasury after undergoing a "stress test" to determine whether additional capital would be needed under certain adverse economic scenarios. Participation in the CAP is mandatory for the 19 largest U.S. financial organizations with banks ("banking organizations"), those with assets in excess of \$100 billion. The results of the stress tests conducted on these banking organizations is scheduled to be released on May 4, 2009. The FRB stated that any banking organizations directed to raise new capital as a result of the these tests should not be viewed as insolvent or unviable. U.S. banking organizations with less than \$100 billion in assets may voluntarily participate in the CAP, and would be subject to a similar stress test as the one described below. For further discussion of the CAP, please see the [February 25, 2009 Alert Special Edition](#).

Under the stress tests, banking organizations were asked to project revenues and credit losses for 2009 and 2010, including the level of reserves that would be needed at the end of 2010 to cover expected losses in 2011, under two alternate economic scenarios. The first, or "baseline," scenario represents a consensus outlook and is based upon economic forecasts at the end of February 2009. The second, or "more adverse," scenario reflects a deeper and longer recession than the baseline scenario. As factors, the Federal banking agencies provided the real GDP growth, civilian unemployment rate and residential home price assumptions for 2009 and 2010 to be used in the baseline and more adverse scenarios. For the baseline scenario, this was a GDP growth rate of -2% in 2009 and 2.1% in 2010, an unemployment rate of 8.4% for 2009 and 8.8% for 2010, and a residential home price index change of -14% in 2009 and -4% in 2010. For the more adverse scenario, this was a GDP growth rate of -3.3% in 2009 and 0.5% in 2010, an unemployment rate of 8.9% for 2009 and 10.3% for 2010, and a residential home price change of -22% in 2009 and -7% in 2010. The FRB noted that economic forecasters have revised their outlooks downward since February, however, the FRB believes that the more adverse scenario continues to account for a more negative economic downturn than the current consensus opinion.

Each participant in the CAP was instructed to project potential losses on its loan, investment and trading securities portfolios, including off-balance sheet commitments and contingent liabilities and exposures. The participating banking organizations were provided with a common set of indicative loss rate ranges for twelve specific loan categories under each of the two economic scenarios. A banking organization could deviate from such loss rate ranges if it could provide evidence that its estimates were appropriate. In addition, firms with trading assets of \$100 billion or more were asked to estimate potential trading-related market and counter-party credit losses under a market stress scenario based on the market shocks that occurred in the second half of 2008. Each participant was also asked to project its pre-provision net revenue – net interest income, fees and other non-interest income net of non-credit related expenses – and its allowance for loan and lease losses established as of December 31, 2008. These projections, combined with existing capital above the amount sufficient to exceed minimum regulatory capital standards, comprised the resources available to absorb capital losses under the economic scenarios.

Each banking organization also reported projections of Tier 1 capital and common shareholders' equity for the end of 2009 and 2010. The projected changes in the levels of capital projected by each banking organization over each of the scenarios reflects a combination of credit losses, pre-provision net income to absorb such losses, and the need to generate an appropriate allowance for loan and lease losses at the end of 2010. The Federal banking agencies projected pro forma capital for 2010 for each banking organization using the revised estimates of credit losses and revenue. No projection was made of any changes in capital participation by private investors or the Treasury. The FRB stated that it did not rely on any single indicator of capital to determine the necessary capital buffer, rather it examined a range of capital indicators, including pro forma equity capital, Tier 1 capital and the composition of capital. The FRB noted that the Federal banking agencies have long indicated that common equity should be the dominant component of Tier 1 capital and thus they examined the level of voting common shareholders' equity for each banking organization. The FRB did not release any specific capital threshold that must be met under the stress tests.

ICI Recommends New Regulatory and Oversight Standards for Money Market Funds

In response to the recent turmoil involving the money market generally and money market funds in particular, the Investment Company Institute (the "ICI") in November 2008 formed a working group of leading industry executives (the "Working Group") to develop recommendations to improve the functioning of the money market and the operation and regulation of funds investing in that market. The ICI's Board of Governors recently adopted without modification all 24 of the Working Group's recommendations. The Independent Directors Council, among others, has endorsed the Working Group's recommendations.

The Working Group's primary focus was on money market funds, *i.e.*, registered investment companies that comply with Rule 2a-7 under the Investment Company Act of 1940 (the "1940 Act"). Rule 2a-7 allows a registered investment company to maintain a stable net asset value per share by exempting it from the 1940 Act's requirement that for pricing fund shares for purchases and redemptions, the fund's portfolio securities should be valued at market quotations if readily available, and otherwise at fair value. To comply with the rule, however, a fund must meet strict requirements relating to the quality and length of maturity for its portfolio securities, as well as overall portfolio diversification. In

addition, a registered investment company may not call itself a money market fund or have a similar name unless it complies with Rule 2a-7. Among the Working Group's recommendations were recommendations to help differentiate money market funds from U.S. and offshore collective investment schemes that compete with money market funds but which do not follow some or all of Rule 2a-7's risk-limiting requirements.

The Working Group's recommendations expressly address two themes. First, money market funds should be better positioned to sustain prolonged and extreme redemptions pressures. Second, if a run on a money market fund should occur, the run should be stopped immediately and all investors in the fund treated fairly. The Working Group's recommendations are as follows:

Liquidity Requirements and Stress Testing:

- The SEC should amend Rule 2a-7 to require taxable money market funds to meet a minimum daily liquidity under which a standard 5% of a fund's assets would be held in securities accessible within one day.
- The SEC should amend Rule 2a-7 to require all money market funds to meet a minimum weekly liquidity under which a standard 20% of a fund's assets would be held in securities accessible within 7 days.
- The SEC should amend Rule 2a-7 to require all money market funds to "stress test" their portfolios regularly to assess a portfolio's ability to meet hypothesized levels of credit risk, shareholder redemptions, and interest rate changes.

Portfolio Maturity:

- The SEC should amend Rule 2a-7 to reduce the weighted average maturity limitation for money market funds from 90 days to 75 days.
- The SEC should amend Rule 2a-7 to require that money market funds also meet a new weighted average maturity requirement, which the Working Group refers to as "spread WAM." For spread WAM purposes, a security's maturity is its stated final maturity date or the date on which the fund may demand payment of principal and interest (*i.e.*, without consideration of any interest rate reset dates of variable- and floating-rate securities). Under the Working Group's recommendation, a money market fund's spread WAM could not exceed 120 days.

Credit Analysis:

- The SEC should amend Rule 2a-7 to require money market fund advisers to establish a "new products" or similar committee that would review and approve new structures prior to investment by their funds.
- A money market fund's adviser should consider and, when appropriate, follow best practices in connection with its minimal credit risk determinations.
- The SEC should retain Rule 2a-7's references to nationally recognized statistical rating organizations, or NRSROs, as an important "floor" on permissible investments.

- The SEC should amend Rule 2a-7 to require money market fund advisers to designate and publicly disclose, pursuant to procedures approved by the fund's board of directors, a minimum of three NRSROs that the fund's adviser will monitor for purposes of determining eligibility of portfolio securities.

Assessments of Client Risk:

- The SEC should require money market funds to develop procedures for admitting shareholders to their funds to ensure, to the extent possible, that funds (a) understand the expected redemption practices and liquidity needs of those investors, or (b) when such information is not available, mitigate possible adverse effects that may result from such unpredictability.
- The SEC should require money market funds to post monthly website disclosures of client concentration levels by type of client and the risks that such concentration, if any, may pose to the fund.

Suspension of Redemptions:

- A money market fund's board, including its independent directors, should be authorized to suspend under exigent circumstances fund redemptions and purchases for 5 business days if a fund has broken, or the board reasonably believes the fund may be about to break, a dollar so that the fund may (a) seek credit support or otherwise address the net asset value, or (b) determine to suspend redemptions permanently and liquidate the fund.
- The SEC should adopt a rule, or make temporary Rule 22e-3T under the 1940 Act permanent, to permit a money market fund permanently to suspend redemptions upon the fund board's decision to liquidate the fund. Temporary Rule 22e-3T was discussed in the [November 25, 2008 Alert](#).

Disclosure Regarding Money Market Funds and Similar Unregistered Products:

- Money market funds should be required to reassess and, if appropriate, revise the risk disclosures they provide to investors and the markets.
- The SEC should require money market funds to provide monthly website disclosure of portfolio holdings.
- The SEC should adopt a rule under the Investment Advisers Act of 1940 designed to reduce investor and market confusion about funds that appear to be similar to money market funds, but do not comply with the risk-limiting provisions in Rule 2a-7 applicable to money market funds. The new rule would apply to investment advisers to collective investment schemes that are not registered investment companies.

Government Oversight:

- The money market industry should work with the appropriate government entity to develop a nonpublic reporting regime for all institutional investors in the money market to report data that would assist the government entity to fulfill its mission of overseeing the markets as a whole.

- The SEC should formalize a program under which SEC staff would monitor each money market fund category for funds whose performance (excluding the effect of fees) clearly exceeds their peers' during any month and determine the reasons for such outperformance. The program would also monitor an additional 10 randomly selected funds each month.

Modifications to Rule 17a-9:

- The SEC should amend Rule 17a-9 under the 1940 Act to allow an affiliated person of a money market fund to purchase an "Eligible Security" from a fund. Section 17(a) of the 1940 Act prohibits an affiliated person of a registered investment company from acting as a principal in certain transactions with the registered investment company. Rule 17a-9 is an exemption from Section 17(a), and it currently permits an affiliated person of a money market fund to purchase from the fund a security that no longer is an Eligible Security.
- The SEC should amend Rule 2a-7 to require nonpublic notice to the SEC of any affiliated purchase in reliance on Rule 17a-9.

Government Programs:

- The U.S. Treasury should extend the Treasury Guarantee Program until the program expires by its terms on September 18, 2009. The U.S. Treasury already has taken this step as reported in the [March 31, 2009 Alert](#).
- The SEC staff should be given the authority to reinstate no-action relief permitting money market funds to use amortized cost for shadow pricing certain securities, under specified market conditions (as described in the [October 14, 2008 Alert](#)), either at the staff's own motion or upon request by the industry.

Forward-Looking Enhancements:

- The SEC should amend Rule 2a-7 to eliminate "Second Tier Securities" from the rule's definition of an Eligible Security.
- The SEC should modernize Rule 2a-7 to reflect the appropriate oversight role for money market fund boards of directors. The Working Group noted that currently Rule 2a-7 only imposes on fund boards a number of responsibilities, many of which it expects the boards to delegate.

Recommendations from Other Sources: The Working Group also examined a number of recommendations from other sources, including (a) requiring money market funds to "float" their net asset values per share, instead of permitting them to maintain a stable net asset value per share, (b) subjecting money market funds to minimum capital requirements, (c) separating money market funds into those that are intended for retail clients and those that are intended for institutional clients and (d) giving more authority to money market funds to permit in-kind redemptions under certain circumstances. The Working Group stated that it elected not to endorse any of those other recommendations.

* * *

Some of the Working Group's recommendations probably will be adopted without much criticism. The SEC already issues, for example, no-action letters relating to purchases of Eligible Securities by affiliated persons, which is similar to the Working Group's Rule 17a-9 recommendation. We expect, however, that other recommendations of the Working Group are likely to encounter objections from certain quarters. In particular, we expect that money market funds distributed primarily through third-party distribution channels will object to any proposal that would require them to develop procedures for admitting shareholders. Investment advisers to unregistered funds that compete with money market funds also would probably object to any proposal that limits or otherwise restricts their management of those funds, especially as those unregistered funds are not intended for sale to retail investors, but only to institutional investors, who are assumed to have the sophistication to protect their own interests.

Policy Change Regarding Massachusetts Tax on Non-Filing Financial Institutions Having Economic Nexus with Massachusetts

In Technical Information Release 09-7 ("TIR 09-7"), the Massachusetts Department of Revenue (the "DOR" or the "Department") announced another change in its non-filer "look-back" policy that applies to a financial institution that has failed to file required Massachusetts tax returns.

Background. When a taxpayer fails to file a required tax return, the DOR may make an assessment of tax at any time for any taxable period for which a return was due. The statute does not limit the number of past due returns or past tax periods for which the DOR may assess tax. However, the DOR, in previously issued TIR 03-17, provided a general seven-year look-back rule and a special three-year look-back rule for certain taxpayers that voluntarily disclosed their failure to file, provided that there was a reasonable doubt that they had an obligation to file Massachusetts returns.

TIR 03-17 states as a general rule, subject to certain exceptions, that when the DOR determines that a taxpayer has failed to file required tax returns, the DOR will assess the taxpayer with respect to returns due during the most recent seven years. However, to encourage voluntary compliance, TIR 03-17 also states that the Department, subject to certain exceptions, will limit assessments to the three most recent tax years in cases where certain non-filers voluntarily disclose their failure to file. TIR 03-17 states that in cases in which a taxpayer seeks to apply the DOR's three-year look-back policy, the DOR will nonetheless apply the seven-year policy, notwithstanding any voluntary disclosure, when an extensive level of business activity conducted in this state removes any reasonable doubt as to the taxpayer's prior filing obligation. Further, TIR 03-17 states that its discretionary policy is subject to exceptions based on consideration of particular facts and circumstances, in which cases the Department may require additional returns to be filed going back in excess of seven years. In determining whether an exception applies, the DOR will consider whether the taxpayer has any basis for reasonable doubt about its obligation to file Massachusetts returns.

In Technical Information Release 08-4 ("TIR 08-4"), the DOR modified the TIR 03-17 rules for financial institutions that are presumed under the statute to be "engaged in business in the commonwealth" because of in-state lending and ancillary loan activity that exceeds specified amounts. Instead of the three-year look-back period, the DOR would apply a five-year look-back period requiring tax filings for the tax years beginning with the tax year

ending after January 1, 2003, if, by September 30, 2008, the taxpayer identified itself to the DOR as availing itself of the terms of TIR 08-4 and filed its returns and made full payment of the tax due and applicable interest and penalties by December 31, 2008. Penalties generally were not waived under TIR 08-4 as they would have been if the general voluntary disclosure provision under TIR 03-17 applied. (The TIR also applies to certain non-Massachusetts corporations that use their intangible property within Massachusetts to generate gross receipts within the state for the corporation, including through a license or franchise.) In TIR 08-4, the DOR warned that it would not be bound by the seven-year look-back period provided in TIR 03-17 and “[would] apply a look-back period that is appropriate to the circumstances” to a financial institution within the scope of the TIR that did not voluntarily file returns under the provisions of the TIR. The DOR was implicitly threatening, if an entity’s facts otherwise supported such an extended look-back period, to assess a financial institution for all tax years beginning on or after January 1, 1995.

Additional Changes in the Look-Back Policy. The five-year look-back period in TIR 08-4 applied only to a taxpayer that, by September 30, 2008, identified itself to the DOR as availing itself of the terms of TIR 08-4 and filed its returns and made full payment of the tax due and applicable interest and penalties by December 31, 2008; therefore it is no longer available. Until TIR 09-7 was issued, the DOR “[would] apply a look-back period that is appropriate to the circumstances.” In TIR 09-7, the DOR announces new look-back policies for financial institutions (and the same types of intangible holding corporations identified in TIR 08-4). The new rules provide that the DOR will apply a look-back period in these cases that requires tax filings for all tax years beginning with the tax year ending on or after January 1, 2001, provided that the taxpayer identifies itself to the DOR, files its returns and makes full payment of the tax due, including any applicable interest and penalties, within a reasonable period of time that the Department may establish depending on the facts of each case. The provisions of the TIR only apply when the taxpayer’s filings are made in good faith in accordance with all applicable tax rules, including the pertinent corporate apportionment rules and all other applicable rules as stated in the Department’s public written statements.

In the case of any taxpayer that is within the scope of the TIR but does not voluntarily file under its terms, the DOR “will apply a look-back period that is appropriate to the circumstances and will not be bound by any previous publicly announced policy regarding look-back periods.” Accordingly, the DOR is implicitly threatening, if the entity’s facts otherwise support such an extended look-back period, to assess a financial institution for all tax years beginning on or after January 1, 1995. Although the DOR has authority to waive penalties for failure to timely file or pay a tax when a taxpayer demonstrates that the failure to file or pay resulted from reasonable cause and not willful neglect, it will generally not waive penalties in the cases to which TIR 09-7 applies.

Possible Action. Even though the terms offered by TIR 09-7 are not attractive because of the relatively long look-back period and the failure to waive penalties, a taxpayer may choose to make voluntary disclosure because of the threat of an extended look-back period. Moreover, under the new combined return rules applicable for tax years beginning on or after January 1, 2009, the DOR will be able to easily identify non-filing taxpayers that have an affiliate in a unitary business that files Massachusetts tax returns.

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Lynne B. Barr
Gary A. Beller
Raymond P. Boulanger
Agnes Bundy Scanlan
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Derek N. Steingarten
William E. Stern
Kimberly K. Vargo
Michael P. Whalen

OTHER ITEM OF NOTE

SEC Approves FINRA Amendments to NASD Rule 2821 Governing Variable Annuity Sales and Exchanges

The SEC approved changes proposed by the Financial Industry Regulatory Authority (“FINRA”) to NASD Rule 2821, which establishes suitability, supervisory and training requirements for sales and exchanges of deferred variable annuities. The proposed amendments were covered in the [June 10, 2008 Alert](#). The amendments: (1) limit the rule to recommended transactions; (2) modify the timing for the principal review requirement to begin on the date when the broker-dealer’s office of supervisory jurisdiction receives a complete and correct copy of the variable annuity application; and (3) revise the rule’s supplementary guidance to permit broker-dealers to forward funds to insurance companies prior to completion of the principal review under certain circumstances. The effective date of the rule will be delayed by 240 days following the publication of FINRA’s regulatory notice announcing SEC approval.