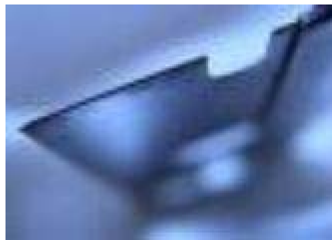
Razor Alert



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Financial Services Update

This Razor Alert incorporates recent developments in the financial services area:

- Analyst Conflict of Interests
- SEC Studies Derivatives Use in Mutual Funds and ETFS
- SEC Warns Firms on Muni Pay-to-Play Rules
- Treasury to sell Citigroup Stock
- Fed Rules on Gift Cards
- Federal Banking Agencies Issue Policy Statement on Funding and Liquidity Risk Management
- FDIC Advisory Committee to Highlight Safe Transactional and Savings Products, Future Strategic Focus
- FDIC Holds Roundtable with Private Investors of Failing Banks
- Senate Banking Committee Issues Clarifications on Effects of Dodd Bill on Community Banks

Analyst Conflicts of Interest

In 2003, a number of the major banking firms entered into the Global Settlement with the SEC, state securities regulators, NASD, and NYSE in response to allegations that their investment banking interests had undue influence on securities research. The SDNY agreed to modify the Settlement paving the way for chaperoned research analyst and investment banking participation in joint due diligence sessions under certain circumstances, involving the issuer and other diligence participants, investment banking and research analysts may now participate in joint due diligence sessions with the issuer or third parties if (1) the joint session takes place after the receipt by the firm of an investment banking mandate, or (2) the joint session: (i) occurs in the context of an investment banking transaction other than an IPO, or (ii) is in connection with a block bid, or with a competitive secondary or follow-on offering or similar transaction in which: (a) the issuer or selling sharehold er has contacted the firm to request that the firm submit a transaction proposal and (b) the firm's legal or compliance staff reasonably believes that the firm will not have a meaningful opportunity to conduct separate due diligence communications with the relevant parties prior to the award of a mandate for the transaction. In addition, legal or compliance personnel or other counsel must chaperone the joint sessions and any subsequent discussions between research and investment banking personnel about the joint sessions.

Investment banking input into the research budget is prohibited;
• The physical separation of research analysts and investment banking is required;
• Investment banking is prohibited from having input into company-specific coverage decisions;
• Research oversight committees are required to ensure the integrity and independence of equity research;
• Communications between investment banking personnel and research analysts regarding the merits of a proposed transaction or a potential candidate for a transaction are prohibited unless a chaperone from the firm's legal and compliance department is present;
• Research analysts and investment bankers are prohibited from having any communications for the purpose of having research personnel identify specific potential investment banking transactions; and
• Research analysts must be able to express their views to a commitment committee about a proposed transaction outside the presence of investment bankers working on the deal.

The SEC supported the continued retention of these provisions in the Addendum.

The Court approved removing a number of provisions from the Addendum because rules issued by the National Association of Securities Dealers Inc. and New York Stock Exchange addressed the same concerns and provided comparable protections. As a result, the Addendum no longer includes prohibitions against investment banking input into research analyst compensation and the bar against research analysts participating in efforts to solicit investment banking business, among other things.

Judge Pauly rejected the one proposed modification that would have allowed investment banking to seek the views of research analysts regarding market or industry trends, conditions, or developments without the requirement of a chaperone, subject to certain limitations including the implementation of controls and training as described in the November 30, 2009 letter to the Court from the Settling Firms.

SEC Studies Derivatives Use in Mutual Funds and ETFS

The SEC staff is conducting a review to evaluate the use of derivatives by mutual funds, exchange-traded funds (ETFs), and other investment companies. The review will examine whether and what additional protections are necessary for those funds under the Investment Company Act of 1940. Pending the review's completion, the staff will defer consideration of exemptive requests to permit ETFs that would make significant investments in derivatives. The staff's decision will affect new and pending exemptive requests from certain actively-managed and leveraged ETFs that particularly rely on swaps and other derivative instruments to achieve their investment objectives.

The staff generally intends to explore issues related to the use of derivatives by funds, including, among other things, whether: (1) current market practices involving derivatives are consistent with the leverage, concentration, and diversification provisions of the Investment Company Act; (2) funds that rely substantially upon derivatives, particularly those that seek to provide leveraged returns, maintain and implement adequate risk management and other procedures in light of the nature and volume of the fund's derivatives transactions; (3) fund boards of directors are providing appropriate oversight of the use of derivatives by funds; (4) existing rules sufficiently address matters such as the proper procedure for a fund's pricing and liquidity determinations regarding its derivatives holdings; (5) existing prospectus disclosures adequately address the particular risks created by derivatives; and (6) funds' derivative activities should be subject to special reporting requirements.

SEC Warns Firms on Muni Pay-to-Play Rules
The SEC issued a report warning firms that municipal securities rules prohibiting pay-to-play apply to affiliated financial professionals such as supervisory executives who are outside the corporate governance structure, as in a holding company or a broker-dealer, not just a firm's employees. The pay-to-play rule, MSRB Rule G-37, generally prohibits firms from underwriting municipal bonds for an issuer for two years after a municipal finance professional (MFP) involved with that firm makes a campaign contribution to an elected official of that municipality.

Treasury to Sell Citigroup Stock
The U.S. Department of the Treasury recently announced its intention to fully dispose of its approximately 7.7 billion shares of Citigroup, Inc. common stock over the course of 2010, subject to market conditions. Treasury received these shares of common stock pursuant to the June 2009 Exchange Agreement between Treasury and Citigroup, which provided for the exchange into common shares of the preferred stock that Treasury purchased in connection with Citigroup's participation in the Capital Purchase Program. The manner, amount and timing of the sales under the plan is dependent upon a number of factors. This disposition does not affect Treasury's holdings of Citigroup trust preferred securities or warrants for its common stock.

Fed Rules on Gift Cards
The Federal Reserve Board announced final rules to restrict the fees and expiration dates that may apply to gift cards. The rules protect consumers from certain unexpected costs and require that gift card terms and conditions be clearly stated. The final rules prohibit dormancy, inactivity, and service fees on gift cards unless: (1) the consumer has not used the certificate or card for at least one year; (2) no more than one such fee is charged per month; and (3) the consumer is given clear and conspicuous disclosures about the fees. Expiration dates for funds underlying gift cards must be at least five years after the date of issuance, or five years after the date when funds were last loaded. The Board's rules generally cover retail gift cards, which can be used to buy goods or services at a single merchant or affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that accepts the card brand. The final rules are issued under Regul ation E to implement the gift card provisions in the Credit Card Accountability Responsibility and Disclosure Act of 2009.

Federal Banking Agencies Issue Policy Statement on Funding and Liquidity Risk Management
The federal banking agencies, in conjunction with the Conference of State Bank Supervisors (CSBS), released a policy statement on their expectations for sound funding and liquidity risk management practices which supplements them with the "Principles for Sound Liquidity Risk Management and Supervision" issued in September 2008 by the Basel Committee on Banking Supervision.

FDIC Advisory Committee to Highlight Safe Transactional and Savings Products, Future Strategic Focus
The FDIC Advisory Committee on Economic Inclusion is meeting to discuss the design and promotion of safe bank accounts for underserved consumers, as well as the committee's strategic focus going forward.

FDIC Holds Roundtable with Private Investors of Failing Banks

Senior officials of the FDIC recently held a roundtable discussion with a wide variety of interested groups, including public interest organizations, pension funds, private investors, investment managers, and others, to discuss the application of the FDIC Statement of Policy on the Acquisition of Failed Insured Institutions, published on September 2, 2009.

The FDIC Statement of Policy on the Acquisition of Failed Insured Institutions provides guidance to investors interested in acquiring or investing in the acquisition of failed banks or thrifts about the standards they will be expected to meet in order to qualify to bid on a failed institution.

Those changes include, for example, refining the description of the types of investors covered, changing the capital standard to one that is a better measure of the capital available to absorb losses, and clarifying the circumstances in which the cross support obligation would apply.

Senate Banking Committee Issues Clarifications on Effects of Dodd Bill on Community Banks

The Senate Banking Committee issued a release clarifying the effects of the financial reform bill on community banks. The financial reform bill is designed to target and imposes greater costs and restrictions on the super-banks, reining in the abuses that caused the crisis, while allowing community banks to continue serving their communities. The provisions clarified include: (1) ending community banks' competition with unregulated non-banks by providing the Consumer Financial Protection Bureau (CFPB) with the ability to adopt rules that prohibit unfair or deceptive practices and with the power to enforce these rules on large banks, mortgage companies, and major players in the shadow banking industry; (2) maintaining single regulator enforcement for community banks by having the rules written by the new CFPB enforced by the same regulator (OCC or FDIC) that enforces safety and soundness rules for banks with assets below $10 billion and providing restrictions on the reac h of the CFPB for banks with assets below $10 billion; (3) preserving dual banking system; (4) requiring that rules written by the CFPB must take into account the costs and benefits to consumers and businesses; (5) prohibiting CFPB fees on small banks or assessments; (6) changing the way the FDIC charges banks assessments to reflect the size of companies' liabilities easing the burden on community banks; (7) creating a systemic-risk regime that would rein in the size and scope of too-big-to-fail institutions; (8) ending too big to fail bailouts by giving the FDIC full resolution authority for the orderly unwinding of systemically dangerous institutions that fail; and (9) easier mortgage disclosure by creating one form that combines the two federal mortgage disclosures currently required, eliminating this burden to small community banks.