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CORPORATE & FINANCIAL
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SEC/CORPORATE

SEC Increases Fees in 2011

On December 22, President Obama signed H.R. 3082, the continuing resolution that will fund federal agencies until approximately February. The resolution has triggered increases in fees collected by the Securities and Exchange Commission. Effective December 27, 2010, the fee rate applicable to registration of securities, registered repurchases of securities by issuers or their affiliates and proxy solicitations and statements in corporate control transactions has increased from $71.30 per $1 million to a new rate of $116.10 per $1 million. The fee change will also affect the fees payable with the Annual Notice of Securities Sold Pursuant to Rule 24f-2 under the Investment Company Act of 1940, which are based on the rate applicable to the registration of securities. Furthermore, effective January 21, the fee rate applicable to securities transactions on exchanges and over-the-counter markets will increase from $16.90 per $1 million in transactions to a new rate of $19.20 per $1 million.

Click here to read the SEC's Fee Rate Advisory #5 for Fiscal Year 2011.

ISS Publishes FAQs for Policies on Proxy Voting Recommendations

On December 14 and January 4, Institutional Shareholder Services (ISS) published FAQs regarding its policies for determining proxy voting recommendations for meetings to be held on or after February 1. As described in the December 3, 2010, edition of *Corporate and Financial Weekly Digest*, ISS previously published its updated recommendation policies for the 2011 proxy season. The FAQs addressed ISS policies related to, among other things, executive compensation, director elections and other corporate governance matters, including the following:

Executive Compensation

- While ISS reiterated its position that it will generally recommend that shareholders vote for annual advisory votes on compensation, ISS clarified that a recommendation by management that shareholders approve say-on-pay votes biennially or triennially would not trigger a negative recommendation for other proxy proposals.

- ISS provided a complete list of "egregious" pay practices that are likely to result in a recommendation by ISS that shareholders vote against (or withhold votes for) say-on-pay proposals.

- ISS addressed whether potentially problematic compensation practices, particularly in the context of accelerated vesting of equity compensation upon the occurrence of a change in control, would be "grandfathered" in ISS's assessment of say-on-pay proposals. ISS noted that, while it will consider existing executive compensation agreements and commitments as part of its "holistic" approach to evaluating say-on-pay proposals, new agreements and amendments to, or extensions of, existing agreements that perpetuate problematic pay practices are the most problematic and will receive the greatest degree of scrutiny. However, automatically renewing or "evergreen" compensation agreements will not be subject to this greater scrutiny. ISS also indicated that equity plans with liberal definitions of "change in control," which are coupled with a provision for full vesting (i.e., single-trigger) upon the occurrence of a change in control are most likely to receive a negative recommendation.

- ISS provided guidance regarding its analysis of "golden parachute" proposals in the context of its policies governing say-on-pay votes and stated it did not have a policy on the inclusion of the golden parachute disclosure in annual meeting proxy statements, but where included, it would be weighed by ISS on the say-on-pay recommendation.

Board Policies

- ISS clarified that where a board is classified and a particular director is not up for election, governance issues related to such director (e.g., poor attendance) would not result in a recommendation that shareholders vote against (or withhold votes for) all nominees up for election at the meeting. However, ISS noted that in egregious circumstances, such as where problematic pay practices exist and no member of the compensation committee is up for election or where a company experiences continued material weakness in its internal controls and no audit committee member is up for election, ISS will recommend that shareholders vote against (or withhold votes for) all nominees.

- ISS clarified its position that it will recommend that shareholders vote against (or withhold votes for) director nominees where a "poison pill" contains so-called "dead hand" or "slow hand" provisions, which limit the ability of new directors to terminate the poison pill, and only permits such termination by continuing directors. ISS also provided sample disclosure for companies to include in proxy statements to provide for a vote on a poison pill at a subsequent meeting, which, in certain circumstances, would avoid a negative recommendation from ISS.

- ISS answered questions regarding its evaluation of board responsiveness to shareholder proposals, explaining, among other things, that "responsiveness" means either implementing a shareholder proposal or submitting the matter to a shareholder vote on the next annual ballot (if shareholder approval is necessary). ISS also clarified that it will provide withhold recommendations if a company fails to respond to a majority-approved shareholder proposal, even if the proponent of the proposal is satisfied with any action (or inaction) taken by the company. The FAQs also covered issues related to proposals seeking to change voting thresholds or the requirements for shareholders to call a meeting.

- ISS clarified that it uses its definition of "independent outside director" for assessing whether a board is "majority independent" and that a board comprised of 50% independent outside directors would not be considered a majority independent board. ISS also provided sample disclosure for companies that intend to add an independent director as well as sample disclosure for use when an affiliated outside director is stepping down from a committee. ISS also provided guidance regarding its views of professional and transactional relationships between directors and the issuer as they relate to ISS's assessment of board independence.

- ISS answered questions regarding the competence of directors, focusing on issues related to meeting attendance and the determination of whether a particular director is "overboarded."

To view the complete text of ISS's FAQs regarding its executive compensation policy, click here.
To view the complete text of ISS's FAQs regarding its audit/board policy, click here.

In addition to the FAQs summarized above, ISS issued FAQs related to its capital/restructuring policy, which can be viewed here.

BROKER DEALER

BATS Proposes Rule Changes Relating to Fees

On January 3, the Securities and Exchange Commission published a notice of proposed rule changes submitted by BATS Exchange, Inc. BATS proposes to modify BATS Rules 15.1(a) and (c), which relate to the fees applicable to its members. Specifically, BATS proposes to revise the "Options Pricing" section of its fee schedule as follows:

1) **Customer Order Pricing**—Decrease the fee for customer orders that remove liquidity from BATS and increase the rebate for customer orders that add liquidity to BATS.
2) **NBBO Setter Rebate**—Where a member meets certain daily average volume requirements, add a rebate for orders that establish a national best bid or national best offer.
3) **Firm and Market Maker Pricing**—Increase the fee for firm and market maker orders that remove liquidity from BATS and increase the rebate for firm and market maker orders that add liquidity to BATS.
4) **Directed ISO Pricing**—Simplify the pricing of all directed ISOs (intermarket sweep orders that bypass BATS's system and are immediately routed to another options exchange specified by the user) by charging a flat rate per contract for such orders.
5) **Routing Pricing**—Establish fees that will apply to all best execution routing strategies offered by BATS and to destination specific order (a market or limit order that instructs BATS's system to route the order to a specified trading center after the order is exposed to BATS's Option Book) routing strategies.

The proposed rule changes became operative on January 3.

To read the SEC release, click here.

CBOE Proposes Rule Change Relating to Order Router Subsidy Program

On January 3, the Securities and Exchange Commission published a notice of a proposed rule change submitted by the Chicago Board Options Exchange (CBOE). CBOE currently makes subsidy payments to CBOE Trading Permit Holders (TPHs) that provide "certain order routing functionalities" to other CBOE TPHs and/or use such functionalities themselves. These payments are meant to subsidize the participating CBOE TPHs' costs of providing such order routing functionalities to other CBOE TPHs.

CBOE proposes to extend its current subsidy program to (1) enable CBOE to establish subsidy arrangements with broker-dealers that are not CBOE TPHs (Non-CBOE TPHs), and (2) extend the program to permit both CBOE TPHs and Non-CBOE TPHs to collect subsidy payments for providing such order routing functionalities to Non-CBOE TPHs.

To read the SEC release, click here.

NASDAQ Proposes Rule Changes Relating to Fee Credits

On January 3, the Securities and Exchange Commission published a notice of proposed rule changes submitted by NASDAQ Stock Market LLC. NASDAQ proposes to modify its Investor Support Program (Rule 7014), which enables NASDAQ members to earn a monthly fee credit for providing additional liquidity to NASDAQ and increasing the NASDAQ-traded volume of what are generally considered to be retail and institutional investor orders in exchange-traded securities. Specifically, NASDAQ proposes to make several adjustments to the Investor Support Program in an effort to moderate the ability of its members, on a prospective basis, to gain fee credits without effectively adding targeted liquidity to NASDAQ.

To read the SEC release, click here.

CFTC

CFTC Publishes Eighth Series of Dodd-Frank Rules

The Commodity Futures Trading Commission has published its eighth series of rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The eighth series of CFTC rules and rule proposals relate to confirmation, portfolio reconciliation and portfolio compression requirements for swap dealers (SDs) and major swap participants (MSPs), registration obligations of derivatives clearing organizations (DCOs) and core principles and other requirements applicable to swap execution facilities (SEFs).

- **Confirmation, Portfolio Reconciliation And Portfolio Compression Requirements for Swap Dealers and Major Swap Participants:** Dodd-Frank directs the CFTC to "adopt rules governing documentation standards" for SDs and MSPs. Accordingly, the CFTC is proposing rules that would impose certain standards on SDs and MSPs regarding the confirmation of swap transactions and the reconciliation and compression of swap portfolios.

The CFTC's stated objective with respect to the proposed confirmation standards is for parties to swap transactions to "have full written agreement on all terms as soon as practicable after execution and also upon any ownership event during the life of the swap." The proposed rules would therefore be applicable to any event that would result in a new swap or a change in the terms of an existing swap, and would vary by transaction, depending on the counterparties. With respect to a swap transaction in which both parties are either an SD or MSP, each party must execute a confirmation of the transaction on the same calendar day as execution. With respect to a swap transaction entered into by an SD or MSP with a counterparty that is neither an SD nor an MSP, the SD or MSP would be obligated to send an acknowledgement of the transaction on the same day as execution and a confirmation of the transaction by the next business day (although if the counterparty is a financial entity, such confirmation must be effected the day of execution). An "acknowledgement" is defined as "a written or electronic record of all the terms of a swap signed and sent by one party to another." A "confirmation" is an acknowledgement that has been verified and signed by the receiving counterparty. SDs and MSPs must also maintain certain records of such acknowledgements and confirmations.

The proposed reconciliation rule would require SDs and MSPs to undertake portfolio reconciliation with respect to a swap transaction entered into with another SD or MSP and not cleared by a DCO. Both counterparties to an uncleared swap must agree in writing to the terms of the reconciliation. SDs and MSPs must reconcile swap portfolios daily, weekly or quarterly, as determined by the size of the particular swap portfolio. SDs and MSPs would also be required to establish written policies and procedures to perform portfolio reconciliation with respect to swap portfolios involving a counterparty that is neither an SD nor an MSP. The proposed rules would also impose certain requirements on SDs and MSPs regarding the resolution of discrepancies in the material terms or valuation of swap transactions, and the maintenance of records concerning such transactions.

With respect to eligible swap transactions in which both parties are either an SD or MSP, the proposed rules would require SDs and MSPs to engage in (1) bilateral portfolio compression exercises annually, and (2) multilateral portfolio compression exercises as required by the CFTC or offered by an applicable DCO or self-regulatory organization. A swap would be excluded from these requirements if including it would be reasonably likely to significantly increase the risk profile of the SD or MSP. In a portfolio compression exercise, "swap market participants whose combined portfolios include outstanding transactions that contain substantially similar economic terms and/or that would result in redundant payments wholly or partially net their swaps by terminating the original swaps and replacing them with a smaller number of new transactions that have a lower gross notional value." Additionally, SDs and MSPs would be required to bilaterally terminate, within one day, all fully offsetting swaps entered into with an SD or MSP counterparty. With respect to swaps entered into by an SD or MSP with a counterparty that is neither an SD nor an MSP, the SD or MSP would be required to maintain written policies and procedures for periodically (1) terminating any fully offsetting swaps and (2) participating in compression exercises, to the extent such swaps can be terminated by compression.

The CFTC has requested comment on various items, including the appropriate effective date for final rules. Comments must be submitted by February 28.

- **Registration Requirements for Derivatives Clearing Organizations:** The CFTC is proposing rules governing the registration process of DCOs. The proposals set forth criteria for compliance with Core Principals applicable to DCOs, including standards for participant and product eligibility, risk management, settlement procedures, treatment of funds, default rules and procedures and system safeguards (such as risk analysis programs and business continuity and disaster recovery plans). The proposed rules would impose greater obligations with respect to such system safeguards on systematically important DCOs in connection with the recovery time objective and geographic diversity. The proposal would replace the current Appendix A to Part 39 of the CFTC rules, *Application Guidance and Compliance with Core Principles*, with a new application for DCO registration, Form DCO.

  The CFTC is also proposing to supplement another recently proposed rule to require DCOs to make certain additional reports to the CFTC, including reporting clearing members' end-of-day customer positions for each beneficial owner.

  The proposals have not yet been published in the *Federal Register*.

- **Core Principles and Other Requirements for Swap Execution Facilities:** Dodd-Frank established a regulatory framework for SEFs by (1) providing a definition of an SEF, (2) requiring that swaps that are required to be cleared under the Commodity Exchange Act (CEA) be executed on a designated contract market (DCM) or an SEF, to the extent a DCM or SEF makes the swap available for trading, and (3) creating registration and core principle requirements for SEFs.

  The proposed rules will: (1) require SEFs to provide a basic functionality that gives all market participants the option to post both firm and indicative quotes to multiple parties, including all other parties participating in the SEF, and (2) provide that SEFs have the option to deploy any trading system or platform that provides this basic functionality, including request for quote systems or order books.

  The CFTC is proposing to implement the execution requirement by allowing “Required Transactions” to be traded on “Request for Quote Systems” or “Order Books.” “Required Transactions” include transactions that: (1) are subject to the clearing and execution requirements under the CEA, (2) are made available for trading, and (3) are not block trades.

  A “Request for Quote System” would include (1) a trading system or platform in which a market participant must transmit a request for a quote to buy or sell a specific instrument to no fewer than five market participants, (2) a trading system or platform in which multiple market participants can both view real-time electronic streaming quotes from multiple potential counterparties on a centralized electronic screen and have the option to complete a transaction by either accepting a firm streaming quote or transmitting a request for quote to no fewer than five market participants, and (3) any other trading system or platform approved by the CFTC.

  “Order Books” would include (1) electronic trading facilities as defined in the CEA, (2) trading facilities as defined in the CEA, (3) trading systems or platforms in which all market participants in the trading system or platform can enter multiple bids and offers, observe bids and offers entered by other market participants and choose to transact on such bids and offers, and (4) any other trading system or platform approved by the CFTC.

  The CFTC is also proposing to adopt regulations and provide guidance and acceptable practices governing the obligations of SEFs to comply with the applicable provisions of the CEA, as amended by Dodd-Frank, including the registration requirements and the 15 core principles under Section 5h of the CEA. Specifically, the proposed regulations, guidance and acceptable practices govern the general obligations of SEFs, including (1) trading and product requirements, (2) compliance and audit-trail obligations, (3) governance and disciplinary requirements, (4) operational capabilities, (5) surveillance obligations, and (6) financial information and resource requirements. The proposed rules further include a Form SEF, which would be used in the application for or amendment to registration as an SEF. The proposed Form SEF provides further guidance on compliance by SEFs with the 15 core principles contained in the CEA.

  The proposed rules have not yet been published in the *Federal Register*. The comment period for these proposals will expire 60 days from the date of their publication in the *Federal Register*.

Information regarding all of the CFTC proposals, including the *Federal Register* releases or CFTC releases (as applicable), fact sheets and Q&As can be found here.

CFTC to Hold Open Meetings Regarding Proposed Dodd-Frank Rules

The Commodity Futures Trading Commission announced that it will hold open meetings on the ninth and tenth series of rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act on January 13 and January 20, respectively.

Details regarding the January 13 meeting are available here, and information about the January 20 meeting is available here.

CFTC Issues Proposal Regarding Conflicts of Interest and Governance Requirements for DCOs, DCMs and SEFs

The Commodity Futures Trading Commission has issued a notice of proposed rulemaking to further implement the Conflict of Interest Core Principles for derivatives clearing organizations (DCOs), designated contract markets (DCMs) and swap execution facilities (SEFs) by addressing, among other things, reporting requirements, obligations of transparency in decision-making and limitations on the use or disclosure of non-public information.

Reporting: Under the proposed rule, an SEF or DCM would be required to report to the CFTC when its board rejects a recommendation from, or supersedes an action of, the regulatory oversight committee or the membership or participation committee. A DCO would be required to report to the CFTC when its board rejects a recommendation from, or supersedes an action of, the risk management committee, or when the risk management committee rejects a recommendation, or supersedes an action of, its subcommittee. Further, the regulatory oversight committee of each SEF or DCM would be required to prepare an annual report assessing the regulatory program of such entity.

Governance Fitness Standards: The proposed rules would require DCMs and DCOs to establish and enforce appropriate fitness standards for their members or directors, members of any disciplinary panel or disciplinary committee and certain affiliates, and to collect and verify data evidencing compliance with these standards. Each DCO would also be required to establish transparent governance arrangements in order to permit, among other things, the consideration of the views of owners and participants.

Risk Management Committee: The proposals would require the risk management committee of a DCO to be composed of at least 35% public directors and at least 10% customer representatives.

Diversity of Board of Directors: Each DCM that is publicly listed on a domestic exchange must endeavor, under the proposed rules, to recruit individuals to serve on its board of directors and other decision-making bodies from among, and to have the composition of the bodies reflect, a broad and culturally diverse pool of qualified candidates.

Composition of Governing Boards: The proposed rules would establish a requirement that each DCM design and institute a process for considering the range of opinions held by market participants regarding the function of existing markets and new rules or rule amendments. Each DCO would need to ensure that the composition of its governing board or committee includes market participants, and that its board of directors is comprised of at least 10% representatives of customers.

Regulatory Program: Under the proposed rules, each DCO, DCM and SEF would have to implement a regulatory program to identify, on an ongoing basis, existing and potential conflicts of interest, as well as a method for making fair and non-biased decisions in the event of such a conflict.

Limitations on Use or Disclosure of Non-Public Information: Under the proposals, each DCO, DCM and SEF would be required to establish and maintain written policies and procedures that limit the use or disclosure of non-public information by owners, members of the board, members of any committee, officers or other employees.

Transparency of Governance Arrangements: Each DCO, DCM and SEF would need to make certain information on governance arrangements available to the public and relevant authorities, including summaries of significant decisions.

Comments regarding the notice of proposed rulemaking must be submitted by March 7. The *Federal Register* release can be found here.

DOJ Recommends Tighter Ownership Restrictions and Conflict Rules for DCMs, DCOs and SEFs

The U.S. Department of Justice (DOJ), in a comment letter submitted to the Commodity Futures Trading Commission, has urged the implementation of more-stringent rules relating to ownership and conflicts of interest for designated contract markets (DCMs), derivatives clearing organizations (DCOs) and swap execution facilities (SEFs). The DOJ comment letter was submitted in response to an October 2010 rule proposal by the CFTC, which would impose specific structural governance requirements and limitations on the ownership of DCMs, DCOs and SEFs.

In its letter, the DOJ expressed concern that the ownership limitations proposed for DCMs and SEFs, which limit the voting power that may be exercised by any single member thereof, do not also include aggregate voting limitations to restrict the aggregate voting power that may be held by major dealers and financial institutions. Absent such limitations, the DOJ is concerned that such entities may be able to use their control over these trading platforms to limit competition. The DOJ also recommends enhancing the CFTC's proposed governance requirements by increasing the participation of independent directors on DCM, DCO and SEF boards and/or board committees.

The DOJ comment letter is available here. The CFTC's rule proposal is available here.

CFTC Issues Exemptive Order for Certain Options on the CBOE Gold ETF Volatility Index

The Commodity Futures Trading Commission has issued a final order exempting the trading and clearing of certain options (Exempted Options) from the Commodity Exchange Act and regulations thereunder to the extent needed to allow such options to be traded on national securities exchanges and cleared though the Options Clearing Corporation. Exempted Options include options on (1) the CBOE Gold ETF Volatility Index (which measures the implied volatility of options on shares of the SDPR Gold Trust, an exchange traded fund (ETF) that intends to reflect the performance of the price of gold bullion), and (2) any other index that measures the volatility of the price of shares of gold ETFs.

The *Federal Register* release of the order can be found here.

NFA Provides Guidance Regarding CPO/CTA Incentive Fee Conflicts Disclosures

The National Futures Association (NFA) has published a Notice to Members which provides guidance to registered commodity pool operators (CPOs) and commodity trading advisors (CTAs) regarding their disclosure of conflicts of interest arising from the collection of incentive fees. The NFA guidance is based upon guidance that NFA received from the Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight (DCIO), which oversees NFA in its review of CPO and CTA Disclosure Documents.

In its letter, DCIO noted that typical incentive fee arrangements, in which a CPO or CTA receives a fee or other compensation based upon its trading performance, could be viewed as creating a conflict of interest between the CPO or CTA and its pool investors or clients by encouraging the CPO or CTA to take excessive risks and/or maximize short-term performance in order to earn outsized incentive fees. Accordingly, the DCIO letter prescribes that every CPO and CTA that charges an incentive fee of this type must include discussion in its Disclosure Document that such fees may encourage the CPO/CTA to take excessive risk and may place the interests of the CPO/CTA in conflict with those of its clients or investors. In its Notice to Members, NFA urges its CPO and CTA members to review their Disclosure Documents and include any additional disclosures prior to submitting any subsequent filings of the document. Although NFA's Notice to Members does not expressly discuss the status of registered CPOs and CTAs that rely upon the relief provided under CFTC Rule 4.7, or of CPOs and CTAs that are exempt from registration with NFA, because such CPOs and CTAs are not required to prepare and file Disclosure Documents with NFA, they are not directly affected by the NFA's Notice to Members.

The NFA Notice to Members is available here.

LITIGATION

District Court Grants Defendants' Motion to Dismiss Securities Fraud Claim

A district court granted defendants' motion to dismiss plaintiffs' claim for securities fraud on the ground that the complaint failed to plead fraud with particularity, as required by the Private Securities Litigation Reform Act of 1995 (PSLRA).

In September 2009, individual defendants allegedly represented to plaintiff Dupont, then president and chief executive officer of defendant Freight Feeder, that they had obtained investors in one of Freight Feeder's programs, and that they would need to assume control of Freight Feeder to secure additional venture capital. As a result, Dupont agreed to a buyout agreement pursuant to which he surrendered his interest in, and control of, Freight Feeder in exchange for an up-front payment of $12,000 and monthly payments of $12,000 in each of the 36 months following the closing of the buyout agreement.

Defendants only made three payments to Dupont under the buyout agreement, and after learning from defendant Bridges that Freight Feeder wanted to sell Freight Feeder's assets and retain its liabilities in an empty corporate shell, plaintiffs brought suit claiming, among other things, securities fraud on the part of defendants in connection with the buyout agreement. Defendants moved to dismiss the action on the grounds that, among other things, the district court lacked subject matter jurisdiction, because the complaint failed to state a cause of action for securities fraud.

In granting defendants' motion to dismiss, the district court found that, contrary to the pleading standards set forth in the PSLRA, the complaint did not contain any alleged misrepresentations of the defendants that include the time, place and identity of the speaker, or the content of the alleged misrepresentation. The district court also held that the complaint failed to plead scienter with the requisite particularity. (*Dupont v. Freight Feeder Aircraft Corp.,* No. 4:10-CV-239-A, 2010 WL 5093159 (N.D.Tex. Dec. 7. 2010))

District Court Dismisses Antitrust Claim Against Direct Broadcast Satellite Television Provider

Plaintiff, a major direct broadcast satellite (DBS) television provider and holder of seven registered trademarks and service marks incorporating the word "DISH," brought an action against defendants alleging that defendant Dish 1 Up, a retailer of another major DBS provider, operates call centers using a "confusingly similar phone number" to plaintiff's 1-800 number to mislead and confuse consumers. Defendants pled several counterclaims against plaintiff, alleging that plaintiff improperly secured a trademark on the generic word "DISH," and that due to this improper and invalid trademark, plaintiff has engaged in predatory and anticompetitive acts, including claiming exclusive common law trademark rights in "vanity" telephone numbers and asserting exclusive trademark rights to marketing phrases containing the generic word "DISH."

In finding that defendants failed to adequately allege antitrust injury, the district court cited to Sixth Circuit Court of Appeals precedent, holding that in an antitrust action a plaintiff must show that (1) the alleged violation tends to reduce competition in some market and (2) the plaintiff's injury would result from a decrease in that competition rather than from some other consequence of the defendant's actions. While plaintiff adequately alleged anti-competitive behavior on the part of defendants, it alleged injury resulting from this anti-competitive behavior in a conclusory fashion, insufficient to survive a motion to dismiss. (*Dish Network, LLC v. Fun Dish, Inc.,* No. 1:08 CV 1540, 2010 WL 5230860 (N.D.Ohio Dec. 16, 2010))

BANKING

Federal Reserve Issues Interim TILA (Regulation Z) Rule Revising Previous Interim Rule

On December 22, the Board of Governors of the Federal Reserve System approved an interim rule amending Regulation Z, which implements the Truth in Lending Act (TILA). The Board issued the interim rule "to clarify certain aspects of a September 24, 2010 interim rule," in response to public comments.

The September 2010 interim rule requires creditors who extend consumer credit secured by real property or a dwelling to disclose summary information about interest rates and payment changes in a tabular format. (The interim rule implements provisions of the Mortgage Disclosure Improvement Act (MDIA) which amended TILA to require mortgage lenders to disclose examples of how a loan's interest rate or monthly payments can change. Those statutory amendments will become effective on January 30.)

The MDIA seeks "to alert borrowers to the risks of payment increases before they take out mortgage loans with variable rates or payments." Under the Board's September interim rule, lenders' cost disclosures must include a payment summary in the form of a table stating the initial rate and corresponding periodic payment and, for adjustable-rate loans, the maximum rate and payment that can occur during the first five years as well as a "worst case" example showing the maximum rate and payment possible over the life of the loan.

This interim rule clarifies that creditors' disclosure should reflect the first rate adjustment for a "5/1 ARM" loan because the new rate typically becomes effective within five years after the first regular payment due date. The interim rule also corrects the requirements for interest-only loans to clarify that creditors' disclosures should show the earliest date the consumer's interest rate can change rather than the due date for making the first payment under the new rate. The rule also clarifies which mortgage transactions are covered by the special disclosure requirements for loans that allow minimum payments that cause the loan balance to increase.

Creditors have the option of complying with either the Board's September 2010 interim rule as originally published or as revised by this interim rule until October 1, 2011, at which time compliance with this interim rule will become mandatory.

The Board is soliciting comment on the interim rule for 60 days after publication in the *Federal Register*.

Read more.

FHFA Adopts Final Rule on Fannie Mae and Freddie Mac Portfolio Holdings

On December 22, the Federal Housing Finance Agency (FHFA) adopted a final rule for Fannie Mae and Freddie Mac (the Enterprises) pertaining to portfolio holdings. The final rule implements section 1109 of the Housing and Economic Recovery Act of 2008 (HERA) and adopts without change FHFA's interim final rule on portfolio holdings, which was effective January 30, 2009. The final rule establishes, as the standard for the Enterprises' portfolio holdings, the criteria set forth in the Senior Preferred Stock Purchase Agreements (PSPAs), which specified that each Enterprise may hold mortgage assets up to $900 billion as of December 31, 2009. Under the final rule, for each subsequent year starting December 31, 2010, each Enterprise is required to reduce its maximum holdings of mortgage assets by 10% of the maximum limit in the preceding year until the limit reaches $250 billion. At that point, no further reduction in the maximum limit is "currently" required.

The PSPAs were entered into to on behalf of the Enterprises by the FHFA acting as conservator and the U.S. Treasury Department to capitalize the Enterprises following severe losses by the Enterprises in 2007. In return for the support provided through the PSPAs, Fannie Mae and Freddie Mac provided certain compensation (including preferred stock and warrants) to the Treasury and accepted various restrictions. Following additional amendments to the PSPAs, on December 24, 2009, the parties again amended the PSPAs to provide further capital to the Enterprises, which had depleted all their capital and had combined losses that required them to draw $150.8 billion of senior preferred stock pursuant to the PSPAs through September 2010. The latest amendment let stand the maximum allowable amount of mortgage assets each Enterprise could own on December 31, 2009—$900 billion. However, the covenant requiring the Enterprises to reduce their mortgage assets was revised such that it is based on the maximum amount that they were permitted to own as of December 31 of the immediately preceding calendar year, rather than the amounts they actually owned at that time.

The rule is effective upon publication in the *Federal Register*.

Read more.

OCC Describes Small Business Lending Fund Program and Underwriting Standards for National Banks

On December 21, the Office of the Comptroller of the Currency (OCC) issued Bulletin 2010-45, which describes how national banks can apply to receive Tier 1 capital in exchange for lending to small businesses. The Small Business Lending Fund (SBLF) aims to stimulate small business lending by providing capital to participating community banks, generally defined as those banks with $10 billion or less in assets. The U.S. Treasury Department will provide banks with capital by purchasing Tier 1-qualifying preferred stock or equivalents in each bank. The price a bank pays for SBLF funding will be reduced as the bank's small business lending increases. (The program is also available to state-chartered banks as well as savings banks and their holding companies.) The dividend rate on SBLF funding will be reduced as a participating community bank increases its lending to small businesses. The initial dividend rate will be, at most, 5%. If a bank's small business lending increases by 10% or more, then the rate will fall to as low as 1%. Banks that increase their lending by amounts less than 10% can benefit from rates set between 2% and 4%. If lending does not increase in the first two years, however, the rate will increase to 7%. After 4.5 years, the rate will increase to 9% if the bank has not already repaid the SBLF funding.

The SBLF was created pursuant to the Small Business Jobs Act of 2010, which directs the Treasury, acting through its Secretary, to make capital investments in eligible financial institutions to address the continuing effects of the financial crisis on small businesses and to increase those businesses' access to credit. The Act authorizes the Treasury to purchase up to $30 billion in preferred stock and other financial instruments from financial institutions to increase the availability of credit for small businesses.

Click here to read OCC Bulletin 2010-45.
Click here to read more about the Small Business Lending Fund.

STRUCTURED FINANCE AND SECURITIZATION

New Guidance on Loan Modifications: IRS Finalizes Rules on Issuer's Credit Quality and Provides a Safe Harbor for REITs

On January 6, the Internal Revenue Service issued final regulations (T.D. 9513) under U.S. Treasury Department Regulation Section 1.1001-3 clarifying that a change in the issuer's credit quality between the issue date and the modification date of a debt instrument is not considered in determining the nature of the instrument or property that results from modification of the debt instrument. For example, a decrease in the fair market value of a debt instrument between the issue date and modification date is not taken into account if it is attributable to the deterioration of the obligor's financial condition and not to a modification of the instrument's terms. This rule does not apply if the modification includes the substitution of a new obligor or the addition or deletion of a co-obligor.

On January 5, the IRS released Revenue Procedure 2011-16 with respect to modifications of mortgage loans held by a real estate investment trust (REIT). If a mortgage loan modification qualifies for the safe harbor described below, then (1) the REIT is not required to treat it as a new commitment to make or purchase a loan for purposes of ascertaining the loan value of the real property; (2) the modification is not a prohibited transaction; and (3) the IRS will not challenge the REIT's treatment of a loan as a real estate asset if the REIT computes the loan value using one of the acceptable methods provided by Revenue Procedure 2011-16.

The new safe harbor applies to a mortgage loan modification which (or an interest in which) is held by an REIT if either (1) the modification was occasioned by default, or (2) the modification satisfies both of the following conditions based on all of the facts and circumstances: (A) the REIT or servicer of the pre-modified loan, after a diligent contemporaneous determination of the risk, reasonably believes that there is a significant risk of default of the pre-modified loan upon maturity of the loan or at an earlier date; and (B) the REIT or servicer reasonably believes that the modified loan presents a substantially reduced risk of default, as compared with the pre-modified loan.

Click here for a copy of the final regulations, and here for a copy of the REIT guidance.

IRS Proposes New Definition of 'Publicly Traded' Property for Purposes of Determining the Issue Price of a Debt Instrument

On January 6, the Internal Revenue Service released proposed rules (REG-131947-10) under U.S. Treasury Department regulation 1.1273-2 that simplify and clarify when property is considered to be "publicly traded" for purposes of determining the issue price of a publicly traded debt instrument and the fair market value of publicly traded property received in exchange for a debt instrument.

The proposed rules would provide that if information about the sales price of a debt instrument (or information sufficient to calculate the sales price) appears in a medium (e.g., the Financial Industry Regulatory Authority's Trade Reporting and Compliance Engine database) that is made available to persons who regularly purchase or sell debt instruments, such debt instruments would be considered publicly traded. The proposed rules also would provide that property is considered to be publicly traded if a firm price quote to buy or sell the property is available or an indicative price quote is provided by a dealer, a broker or a pricing service.

Property listed on an exchange would continue to be "publicly traded," but the current list of foreign exchanges would be replaced and expanded to include any securities exchange that is officially recognized, sanctioned, regulated or supervised by a governmental authority of the foreign country.

The proposed rules would presume that the fair market value of property is its trading price, sales price or quoted price, whichever is applicable.

Click here for a copy of the proposed rules.

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