

Financial Services Alert

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Developments of Note

➤ DOL Requests Comments on Fee Disclosures in 401(k) Plans

The Department of Labor (the "DOL") is currently reviewing the rules under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), applicable to the disclosure of fees and expenses to participants in participant-directed retirement plans (e.g., 401(k) plans). In connection with this review, the DOL recently released a request for information containing 19 specific questions with respect to which the DOL is seeking input. Generally, the DOL is interested in information concerning (i) what information participants should consider, (ii) the manner such information should be provided to participants, and (iii) who should be responsible for providing such information to participants. Comments are due to the DOL no later than July 24, 2007.

➤ IOSCO Seeks Public Comment on Issues Related to Sale of Funds of Hedge Funds to Retail Investors

IOSCO issued a consultation report (the "Report") inviting interested parties to submit their views on key issues that IOSCO could address with respect to funds of hedge funds that sell their shares to retail investors. The Report discusses past IOSCO initiatives in this area, regulatory efforts addressing funds of hedge funds directed at retail investors and a preliminary draft of key issues in this area identified by the IOSCO Technical Committee Standing Committee on Investment Management. The Report identifies regulatory issues and issues regarding managers of funds of hedge funds and the nature of their due diligence with respect to underlying funds. The regulatory issues are as follows:

1. Information regarding underlying funds available to fund of hedge fund managers and investors.
2. Risk management systems for fund of hedge fund managers.

3. Nature of information delivered by funds of hedge funds to their investors and the frequency of delivery.
4. Regulatory restrictions/controls on fund of hedge fund managers' selection of underlying funds (*e.g.*, eligibility criteria for underlying funds, due diligence requirements).
5. Fund of hedge funds' disclosure of performance targets.
6. Fees and expenses (layering of fees, conflicts of interest related to investments in affiliated underlying funds and fee-sharing arrangements between top-tier and bottom-tier funds).
7. Diversification/investment restrictions (limits on direct investments, minimum levels of diversification/limits on concentration).
8. Lock-up periods/liquidity.
9. Valuation (*see* the April 3, 2007 issue of the *Alert* for discussion of the IOSCO Technical Committee report on valuation issues for hedge fund portfolios).
10. Leverage (standards, disclosure).
11. Marketing (suitability).

The report identifies the following issues regarding managers of funds of hedge funds and the nature of their due diligence with respect to underlying funds:

- a. Management due diligence processes.
- b. Underlying funds' transparency as it affects monitoring by fund of hedge funds managers and investors.
- c. Use of side letters.
- d. Delegation/outsourcing of functions by fund of hedge funds managers (*e.g.*, due diligence, calculation of net asset value).

The report solicits comments on the preliminary issues noted above, as well as on any other issues that could be addressed. With respect to U.S. markets, IOSCO encourages responses regarding: (i) funds of hedge funds that are registered as investment companies with the SEC; and (ii) commodity pool operators registered with the CFTC operating funds of hedge funds that claim no exemption from the reporting, disclosure and recordkeeping requirements generally applicable to commodity pools. Comments are due no later than July 20, 2007. If specifically requested, comments may be submitted anonymously; otherwise, they will be made publicly available.

➤ **IRS Issues Guidance on Banks' Treatment of Accrued Loan Interest**

The IRS issued guidance to banks concerning the treatment of uncollected, but accrued, interest income. In Revenue Ruling 2007-32, the IRS held that, even if a bank is required by federal banking rules to suspend the recognition into income of uncollected but accrued interest, the bank must, nevertheless, continue to include the interest in its gross income for federal income tax purposes. The IRS and the courts generally require *substantial* evidence of uncertainty as to collection before the accrual of income can be prevented. The Revenue Ruling also notes that, when an item of income previously accrued subsequently becomes uncollectible, a taxpayer's proper remedy is by way of a bad debt deduction, rather than through the elimination of the accrual, even when the item is accrued and becomes uncollectible during the same taxable year.

The IRS also issued Revenue Procedure 2007-33, establishing the manner in which an accrual method bank that is subject to federal (or equivalent state) regulatory supervision and has uncollected interest may obtain the IRS's automatic consent to change its method of accounting for this interest to the safe harbor method. In general, the safe harbor method allows a bank to determine for each taxable year the amount of accrued uncollected interest that is considered to have a reasonable expectancy of repayment by multiplying the total accrued uncollected interest for the year by a "recovery percentage." The

recovery percentage is the quotient of the payments received during the past five taxable years over the total amounts due and payable during the past five years. The bank includes in its gross income only the portion of accrued but uncollected interest for which it has a reasonable expectancy of payment.

➤ Federal Agencies Issue 2007 National Money Laundering Strategy

The U. S. Departments of Treasury, Justice and Homeland Security (the “Agencies”) jointly issued a report concerning their 2007 National Money Laundering Strategy (the “Report”) to combat money laundering. The Report states that banks remain the primary gateway to the U.S. financial system for money launderers. The Report then describes the challenges faced by financial institutions from:

- (1) criminals attempting to hide their identities and sources of income;
- (2) increased use of the Internet to open and access bank accounts;
- (3) increased numbers of U.S. immigrants who do not have U.S. government-issued identification;
- (4) use of “correspondent,” “payable-through,” and “nested” accounts in connection with international business; and
- (5) cross-border wire transfers.

In addition, the Report describes the Agencies’ strategy for enhancing financial transparency in money services businesses; stemming the flow of illicit bulk cash out of the U.S.; attacking trade-based money laundering in the U.S. and overseas; promoting transparency in the ownership of legal entities; increasing regulation and oversight of the insurance industry and casinos; and supporting global anti-money laundering enforcement efforts “by promoting transparency in the international financial system and encouraging cooperation and coordination among diplomatic, financial and law enforcement authorities.” The Report includes appendices providing, among other things, money laundering threat assessments, statistics demonstrating Federal law enforcement and regulatory actions against money launderers, and the strategic use of asset forfeitures, *i.e.*, money seized and forfeited from criminal enterprises.

➤ The Wolfsberg Group and the Clearing House Issue Joint Statement on Payment Message Standards

In order to promote the effectiveness of global anti-money laundering and anti-terrorist financing programs, The Wolfsberg Group and The Clearing House Association L.L.C. (collectively, the “Industry Associations”) issued a joint statement endorsing measures to enhance the transparency of international wire transfers (the “Joint Statement”). The Wolfsberg Group is an association of 12 global banks whose aim is to develop financial services industry standards and related products for Know Your Customer, Anti-Money Laundering and Counter Terrorist Financing policies. The Clearing House Association LLC is owned by the U.S. affiliates of 22 banks and was established to simplify the exchange of checks and improve the efficiency of the payments system. The Joint Statement recommends (1) the creation of a new or enhanced Society for Worldwide Interbank Financial Telecommunication (“SWIFT”) payment message format for third-party cover payments that enables information regarding the originator and the beneficiary to be included; and (2) the adoption of certain basic payment message standards across the banking industry (the “Proposed Standards”).

The Proposed Standards would require all financial institutions to conduct themselves, and to cooperate with other financial institutions, in a manner that promotes transparency throughout the payment process. Specifically, the Proposed Standards would require financial institutions to: (1) not omit, delete or alter information in payment messages or orders for the purpose of avoiding detection of that information by other financial institutions; (2) not use any particular payment message for the purpose of avoiding detection of information by other financial institutions; (3) subject to all applicable laws, cooperate as fully as practicable with other financial institutions when requested to provide information about the parties involved in international wire transfers; and (4) encourage their correspondent banks to observe the Proposed Standards.

The Industry Associations believe that the new SWIFT message format could be implemented as early as November of 2008 provided that the initiatives endorsed in the Joint Statement receive the support of global regulatory community and the proposed message format is accepted by SWIFT. To that end, the Joint Statement and the initiatives it endorses have received strong initial support from the U.S. bank

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regulatory community. Through a statement issued by Treasury Department Under Secretary Stuart Levey, the Treasury Department and the federal bank regulators applauded the actions of the Industry Associations and pledged the support of the Treasury Department and the federal banking regulators to help bolster support for the initiatives endorsed in the Joint Statement.

➤ **FASB Issues Staff Position Providing Guidance on Determination of When a Tax Position Is Settled for Purposes of FIN 48**

The Financial Accounting Standards Board (“FASB”) issued a staff position (the “FSP”) that amends FASB Interpretation No. 48 (“FIN 48”) to provide guidance on determining whether a tax position is settled for the purpose of recognizing previously unrecognized tax benefits. FIN 48 is designed to clarify the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. Among other things, it prescribes a threshold for financial statement recognition of the benefit of a tax position taken or expected to be taken in a tax return, which also results in financial statement recognition of a tax liability if a tax position does not meet the threshold. As adopted, FIN 48 provides that the tax benefit of an uncertain tax position that does not meet the threshold test of being more likely than not to be sustained based on its technical merits cannot be recognized until it is either ultimately settled with the taxing authority or the statute of limitations for examination has passed. In general terms, the FSP replaces the concept of ultimate settlement with effective settlement. The FSP indicates that settlement has effectively occurred for purposes of recognizing previously unrecognized tax benefits relating to uncertain tax positions that do not meet the more likely than not recognition threshold, if (a) the taxing authority has completed all of its required or expected examination procedures; (b) the enterprise does not intend to appeal or litigate any aspect of the tax position; and (c) it is considered highly unlikely that the taxing authority would reexamine the tax position. The FSP also addresses considerations relevant to the determination of whether a tax position is effectively settled, such as the specificity of a taxing authority’s review and the possibility that a taxing authority might reexamine a tax position. An entity must apply the guidance in the FSP from the date of initial adoption.

Other Items of Note

➤ **SEC’s Office of the Chief Accountant Issues Brochure on Audit Committee Oversight of Auditor Independence**

The SEC’s Office of the Chief Accountant issued a brochure that highlights basic requirements set forth in SEC rules and other guidance governing audit committee oversight of auditor independence. The brochure, which appears designed to be a quick reference for audit committees themselves, is available on the SEC’s website at <http://www.sec.gov/info/accountants/audit042707.pdf>. Additional auditor independence materials are available on the SEC website at <http://www.sec.gov/info/accountants/independref.shtml>.

➤ **Goodwin Procter Issues Client Alerts on Final Section 409A Regulations Affecting Non-Qualified Deferred Compensation Arrangements, Severance Pay and Equity Compensation Arrangements**

Goodwin Procter posted the following three Client Alerts addressing new regulations under Section 409A of the Internal Revenue Code on its website:

“Final Section 409A Regulations Require Prompt Action on Non-Qualified Deferred Compensation Arrangements” http://www.goodwinprocter.com/Files/Publications/CA_409A_NQDC_5_3_07.pdf

“Final Section 409A Regulations and Severance Pay” http://www.goodwinprocter.com/Files/Publications/CA_409A_Severance_5_3_07.pdf

“Final Section 409A Regulations and Equity Compensation Arrangements” http://www.goodwinprocter.com/Files/Publications/CA_409A_EquityComp_5_3_07.pdf