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Financial Services *Alert*

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Developments of Note

♦ SEC Proposes Rule Permitting Manager-of-Managers Arrangements

The SEC proposed new Rule 15a-5 under the Investment Company Act of 1940 (the “1940 Act”) that would eliminate the need to obtain exemptive relief for “manager-of-managers” arrangements by codifying many of the conditions of manager-of-managers exemptive relief granted by the SEC in the past. (In a manager-of-managers arrangement, one or more sub-advisers manage a fund’s assets subject to the supervision of an investment adviser (the “principal adviser”) that may generally hire and fire sub-advisers and materially amend sub-advisory agreements without seeking shareholder approval.) Under the proposed Rule, funds meeting certain conditions would not be required to seek shareholder approval of (a) a sub-advisory agreement with a non-affiliated sub-adviser (or any material amendment to that agreement) or (b) (i) any material amendment to a sub-advisory agreement with a wholly-owned subsidiary of the fund’s principal adviser or (ii) any sub-advisory agreement with a wholly-owned subsidiary of the fund’s principal adviser hired as sub-adviser to replace another wholly-owned subsidiary of the fund’s principal adviser. Reliance on the proposed Rule would be contingent upon the fulfillment of a number of conditions relating to (a) shareholder and/or board approval of a manager-of-managers arrangement, (b) a principal adviser’s supervision of sub-advisers, (c) a principal adviser’s right to terminate a sub-advisory agreement, (d) prohibitions on direct or indirect increases in fund management fees resulting from new or modified sub-advisory agreements, (e) limits on the ownership by a fund’s principal adviser, a fund’s directors and officers and the directors and officers of a fund’s principal adviser of direct or indirect material interests in an unaffiliated sub-adviser, (f) shareholder notification regarding new sub-advisory agreements or material amendments to existing sub-advisory agreements, and (g) fund director independence. Along with Rule 15a-5, the SEC proposed amendments to Form N-1A that would limit the extent to which a fund relying on Rule 15a-5 would need to disclose fees paid to unaffiliated sub-advisers. The SEC has requested comment on a number of features of the proposed Rule and accompanying Form N-1A amendments. Comments must be received on or before January 8, 2004.

♦ OCC Promotes Dual Banking System

The OCC published guidance (the “Guidance,” including by reference to a September, 2003 speech) on the dual banking system. The Guidance details the history of the national bank charter and the legal bases, and limits, of the federal preemption over state law to which they are entitled. In this regard, the Guidance provides that “if the Supreme Court’s decisions can be synthesized into a general rule, it would be that the types of laws that are *not* preempted are typically those that do not regulate the content or extent of the activities authorized for national banks under federal law, but rather establish the legal infrastructure around the conduct of that business. In other words, non-preempted state laws are convenient, useful, and in many cases, necessary, for national banks to conduct their federally authorized business, but they do not obstruct or condition the bank’s ability to exercise powers granted under federal law.” The Guidance also emphasizes the need for a dual banking system for innovation in the banking system, and that, by seeking to limit a national bank’s preemptive authority, state bank regulators are inhibiting that system.

♦ OTS Provides IA Complex Blanket Rebuttals of Control and Concerted Action

The OTS issued an Order (2003-49) providing an investment adviser complex (the “Acquiror”) with a blanket approval of rebuttal of control and concerted action, subject to certain conditions. With respect to the rebuttal of control, the Acquiror sought to acquire between 10% and 25% of a class of any thrift’s equity securities. The Acquiror’s rebuttal of control agreement varied from the standard OTS form in several respects, including: (1) it does not relate to any single thrift, but rather will apply to any thrift; (2) the Acquiror will not have a representative on any thrift’s board; (3) the Acquiror is permitted to engage in arms-length transactions with the relevant thrifts; and (4) the Acquiror will provide the OTS quarterly with an aggregate stockholdings report and certification. As to the rebuttal of concerted action, the Acquiror submitted a description of its structure and operations, noting among other things that: (1) when the Acquiror acquires an investment advisor, although the Advisor holds a majority of the board seats it generally does not participate in the new subsidiary’s day-to-day operations or investment process; (2) the Acquiror’s subsidiaries have independent investment strategies and do not combine their voting power toward any common purpose; and (3) each entity within the Acquiror has established written policies and procedures formalizing informational barriers within the Acquiror.

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If you would like anyone else to receive issues of the *Financial Services Alert*, would like to receive any past issues, or would like the background materials for any of the matters discussed above, please contact **Greg Lyons, Eric Fischer, Elizabeth Shea Fries or Jackson Galloway** at the e-mail addresses referenced at the end of this newsletter.

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♦ SEC Expected to Approve NYSE and Nasdaq Corporate Governance Standards

The NYSE and Nasdaq filed amendments to their proposed listing standards addressing corporate governance issues with the SEC. The amendments are widely believed to be in their final form but are subject to SEC approval before adoption. The proposed governance standards have a more limited effect on listed registered open-end and closed-ends funds (collectively "funds") than on operating companies. (Goodwin Procter's M&A/Corporate Governance Practice has prepared Public Company Advisories that focus primarily on how the revised NYSE and Nasdaq proposals affect operating companies. These Public Company Advisories are available upon request.) The NYSE and Nasdaq amendments exempt funds from certain of the listing organizations' director independence standards as well as requirements relating to nominating and compensation committees, internal audit functions and corporate governance guidelines. Funds (other than NYSE listed open-end funds) are, however, required to comply with a number of audit committee related requirements dealing with, among other matters, audit committee composition and responsibilities. In addition, fund audit committees must establish procedures for the confidential, anonymous submission of concerns regarding questionable accounting or auditing matters not only by fund employees, but also by employees of a fund's investment adviser, administrator, principal underwriter, or any other fund accounting-related service provider. Both NYSE and Nasdaq standards include a provision requiring notice to the listing organization of any material non-compliance with corporate governance standards, but only the NYSE requires an annual certification of compliance, and then only from closed-end funds. Once approved by the SEC, the new corporate governance requirements will generally be mandatory for a fund by the earlier of: (i) the fund's first annual shareholders meeting after January 15, 2004, or (ii) October 31, 2004.

♦ OCC Disapproves CBCA Notice of Issuer of Subprime Credit Cards Regarding Its Intent to Acquire Bank Engaged in Credit Card Lending

The OCC disapproved an acquiror's (the "Proposed Acquiror") notice under the Change in Bank Control Act (the "CBCA") of its intent to acquire a bank (the "Bank") engaged in proprietary credit card lending for its nonbank parent company. The Proposed Acquiror is a credit card company primarily engaged in subprime, unsecured credit card issuance through direct mail, television, telemarketing and the Internet. In its decision, the OCC reviewed the 6 specific grounds under which a bank regulatory agency may disapprove a notice under the CBCA and the OCC made adverse findings with respect to 3 factors: (1) financial condition of the Proposed Acquiror; (2) competence and/or experience of the Proposed Acquiror; and (3) risk of adverse effect on the Bank Insurance Fund ("BIF"). With respect to financial condition, the OCC stated that, among other things, the Proposed Acquiror's uneven earnings history gave the OCC reason to doubt that the Proposed Acquiror had the financial capacity to support the Bank's business plan. As to competence and experience, the OCC noted the Proposed Acquiror's failure to operate its existing credit card business consistently and profitably, as well as the intensely competitive nature of the general purpose credit card market. Finally, with respect to risk to the BIF, the OCC stated that the Potential Acquiror's potential reliance on brokered deposits and the complexities associated with subprime credit card lending and securitization of credit card receivables could cause risk of significant expense to the BIF in the event the Bank were turned over to the FDIC in receivership.

♦ FRB Changes Method for Calculating Income Earned by Banks on Balances

The FRB changed the method it uses for imputing the income Federal Reserve Banks ("FR Banks") earn from clearing balance investments. Depository banks generally hold clearing balances with FR Banks to settle transactions arising from a bank's use of FR Bank priced services. Clearing balances are similar to compensating balances held by a respondent bank with its correspondent bank to support the settlement of payments and pay fees charged by the correspondent bank. The FR Banks impute income on clearing balance investments rather than using actual results from monetary policy investment activities. The FRB stated that rather than using the current method of imputing earnings based upon the assumption that the clearing balances were all invested in three-month U.S. Treasury bills, the FR Banks will impute income on clearing balance investments based upon the assumption that they were invested in a broader portfolio of investments comprised of investments that may be made by banks and bank holding companies. The FR Banks will impute an investment return expressed as a constant annual spread over the interest rate used to determine the cost of clearing balances. The FR Banks will put these changes into effect in January 2004.

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