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DEVELOPMENTS OF NOTE

IRS and Treasury Department Issue Highly-Anticipated FATCA Proposed Regulations

On February 8, 2012, the IRS and the Treasury Department released [proposed regulations](#) under the Foreign Account Tax Compliance Act ("FATCA"). The FATCA provisions, enacted as part of the Hiring Incentives to Restore Employment Act of 2010 ("HIRE Act") and comprised of sections 1471 through 1474 of the Code, create reporting, withholding, and documentation requirements for certain foreign financial institutions ("FFIs") and non-financial foreign entities ("NFFEs") designed to thwart attempts by U.S. taxpayers to avoid tax by using offshore accounts. The proposed regulations contain helpful guidance on both the substantive and procedural elements of the FATCA regime, and modify and expound upon the approach previously outlined in IRS Notices 2010-60, 2011-34, and 2011-53.

Notable provisions of the proposed regulations include the following:

- **Dates extended for grandfathered obligations, FFI reporting on income and gross proceeds.** The proposed regulations designate January 1, 2013 as the date on which outstanding obligations qualify as grandfathered obligations (the date previously designated by the HIRE Act was March 18, 2012). Therefore, no amount shall be deducted or withheld pursuant to FATCA from any payment under any obligation outstanding on January 1, 2013 or from the gross proceeds from any disposition of such an obligation. In addition, in response to comments suggesting more time was needed to prepare for the reporting of income and gross proceeds, with respect to FFIs, income reporting will now be required beginning in 2016 (with respect to the 2015 calendar year) and gross proceeds reporting starts in 2017 (with respect to the 2016 calendar year).

- **Affiliated group FFI requirements.** Generally, in order for any FFI to be a participating FFI (“PFFI”) under FATCA, every other FFI that is a member of the same affiliated group must also qualify as a PFFI or a deemed-compliant FFI. Recognizing that this rule could create problems due to legal prohibitions on elements of FATCA compliance in certain jurisdictions, the IRS and the Treasury Department include a transitional period for this affiliated group rule in the proposed regulations. Before January 1, 2016, as long as the FFI (or branch of FFI) subject to the legal prohibition complies with certain reporting and diligence requirements, other FFIs in the same affiliated group will not be prevented from entering into an FFI Agreement (thus obtaining PFFI status).
- **Expansion of definition of “deemed compliant” FFIs.** IRS Notice 2011-34 provided several categories of FFIs that would be considered deemed-compliant and therefore exempt from withholding without an FFI Agreement. The proposed regulations add to the categories of FFIs that get deemed-compliant status, to include, for example, certain banks and mutual funds which only have local clients and certain retirement plans seen as posing a low risk in terms of the abuses FATCA is designed to prevent.
- **Phase-in of passthru payment regime.** Participating FFIs will be required to begin withholding on passthru payments that are withholdable payments (as defined in the regulations) on January 1, 2014. Beginning no earlier than January 1, 2017, withholding by FFIs with respect to passthru payments will no longer be limited to withholdable payments, and FFIs will be required to withhold on such payments to the extent required by future guidance.

Additional guidance is forthcoming, including the release of a draft model FFI agreement in early 2012. The IRS and the Treasury Department indicate that they plan to make necessary amendments to the regulations in order to prevent the circumvention of reporting and withholding on passthru payments through the use of certain U.S. financial institutions as “blockers.” In an effort to minimize any burden imposed by FATCA provisions, comments are requested concerning practical approaches to the treatment of withholding on passthru payments. Furthermore, an alternative method of compliance with FATCA, under which an FFI would provide relevant information to its residence country government and such government would report the information to the IRS, is under consideration. Persons who wish to submit comments on these regulations must do so in written or electronic form by April 30, 2012.

FinCEN Extends FBAR Filing Deadline Until June 30, 2013 for Certain Financial Professionals

On February 14, 2012, the U.S. Treasury Department’s Financial Crimes Enforcement Network (“FinCEN”) issued [FinCEN Notice 2012-1](#) (the “Notice”), extending until June 30, 2013 the date for filing Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (“FBAR”), by certain individuals with signature or other authority only over certain foreign financial accounts. The Notice further extends the deadlines that were previously extended until June 30, 2012 by FinCEN pursuant to FinCEN Notice 2011-1 (Revised) issued on June 2, 2011 (and discussed in the June 7, 2011 Financial Services Alert) and FinCEN Notice 2011-2, issued on June 17, 2011 (and discussed in the [June 21, 2011 Financial Services Alert](#)) (collectively, the “Prior Notices”). In the Notice, FinCEN

stated that it was further extending the deadlines in the Prior Notices because of additional questions and concerns raised with respect to the exceptions addressed in the Prior Notices.

INDIVIDUALS COVERED BY THE PRIOR NOTICES

FinCEN Notice 2011-1 (Revised) relates to certain exceptions provided in the Final Rule issued by FinCEN that went into effect on March 28, 2011. (The Final Rule was discussed in the [March 1, 2011 Financial Services Alert](#).) In particular, the Final Rule provides filing relief in the form of exceptions for certain officers and employees with signature or other authority over, but no financial interest in, a foreign financial account owned or maintained by an entity described in 31 CFR §§1010.350(f)(2)(i)-(v) of the Final Rule. Those exceptions apply only with respect to accounts maintained by the entity that is the employer of the excepted officer or employee, however, and do not extend, for example, to accounts maintained by a subsidiary of the employer over which such an officer or employee has signature authority. Notice 2011-1 (Revised) provided relief to individuals described in the following two categories:

- (1) an employee or officer of an entity under §1010.350(f)(2)(i)-(v) who has signature or other authority over and no financial interest in a foreign financial account of a “controlled person” of the entity; or
- (2) an employee or officer of a “controlled person” of an entity under §1010.350(f)(2)(i)-(v) who has signature or other authority over and no financial interest in a foreign financial account of the entity, the “controlled person,” or another “controlled person” of the entity.

For this purpose, a “controlled person” means a United States or foreign person more than 50 percent owned (directly or indirectly) by an entity under §1010.350(f)(2)(i)-(v).

FinCEN Notice 2011-2 provided administrative relief in the case of officers and employees of investment advisers registered with the Securities and Exchange Commission (the “SEC”) with signature or other authority over, but no financial interest in, foreign financial accounts of persons that are not registered investment companies. (These individuals are not covered by the exception in §101.350(f)(2)(iii) of the Final Rule for officers and employees of Authorized Service Providers who have signature or other authority over, but no financial interest in, a foreign financial account owned or maintained by an investment company that is registered with the SEC.)

EXTENSION PROVIDED BY THE NOTICE

The extension until June 30, 2013 in the Notice applies to FBARs that would have been due on June 30, 2012 for the reporting of signature authority by individuals who were covered by the Prior Notices as described above. Taken together with the extensions provided in the Prior Notices, the Notice applies with respect to FBARs for calendar year 2011 and 2010, as well as for earlier calendar years for which the filing deadline was properly deferred under the Internal Revenue Service (“IRS”) Notice 2010-23 (discussed in the [March 8, 2010 Goodwin Procter Alert](#)) and IRS Notice 2009-62 ((discussed in the [August 10, 2009 Goodwin Procter Alert](#))). For all other individuals with an FBAR filing obligation, the filing due date remains unchanged.

Massachusetts Adopts Changes to Investment Adviser Registration Exemptions

The Massachusetts Securities Division (the “Division”) adopted [final amendments](#) (the “Amendments”) to its rules that (1) effectively phase out a commonly-used exemption from registration as an investment adviser and (2) create a new private fund adviser registration exemption. The Amendments represent a re-working of the Division’s approach to regulating investment advisers in light of the changes to federal regulation of advisers effected by the Dodd-Frank Act and related SEC rulemaking, which are discussed in detail in the [June 30, 2011 Goodwin Procter Alert](#).

Definition of Institutional Buyer. The Amendments modify the definition of “institutional buyer” under Massachusetts regulations to limit the extent to which investment advisers are exempt from registration with the Commonwealth because their only clients are “institutional buyers.” The Amendments carve back the existing category of institutional buyer that consists of any investing entity that accepts only “accredited investors,” each of whom has invested at least \$50,000. Under the Amendments, that category is subject to further conditions: (a) the funds must have existed prior to February 3, 2012; and (b) they must have ceased accepting new investors as of that date. The Amendments include a grandfathering provision that allows an adviser to continue to treat a fund as an “institutional buyer” if the fund accepts additional investments from pre-February 3, 2012 investors going forward.

Private Fund Adviser Exemption. The Amendments create a new Massachusetts registration exemption for advisers whose only clients are funds excluded from the definition of “investment company” under either Section 3(c)(1) (a “3(c)(1) fund”) or Section 3(c)(7) of the Investment Company Act of 1940. An adviser seeking to rely on this exemption is subject to additional conditions to the extent it advises a 3(c)(1) fund that is not a “venture capital fund” within the meaning of SEC Rule 203(l)-1 under the Advisers Act, which defines the term for purposes of the new venture capital fund adviser exemption created by the Dodd-Frank Act (as discussed in the [June 30, 2011 Goodwin Procter Alert](#)). The adviser must (a) limit the investors in such a non-venture capital 3(c)(1) fund to persons who at the time of investment are “qualified clients” as defined in SEC Rule 205-3 under the Advisers Act (which definition the SEC has amended, as discussed here [<hyperlink to story on final qualified client amendments>](#)); and (b) provide the fund’s investors with (i) certain disclosures at the time of purchase and (ii) annual audited financial statements for the fund. The condition relating to the qualified client status of fund investors requires that an investor deduct the fair market value of that person’s primary residence, less the amount of debt up to fair market value secured by the property, in determining whether the net worth standard has been met, and includes a grandfathering provision for pre-February 3, 2012 funds with non-qualified client investors. All advisers relying on the new private fund adviser exemption must file with the Division the reports filed with the SEC by “exempt reporting advisers.” (The reporting requirements for exempt reporting advisers are discussed in the [June 30, 2011 Goodwin Procter Alert](#).) Relying advisers must also meet a condition regarding the absence of any disqualification based on certain disciplinary matters, and pay a \$300 reporting fee.

Enforcement. The Division will begin enforcing the Amendments August 3, 2012.

SEC Adopts Changes to Advisers Act Rule Permitting Performance-Based Advisory Fees

The SEC [adopted](#) amendments (the “Amendments”) to Rule 205-3 under the Investment Advisers Act of 1940, which permits a registered adviser to charge a performance-based advisory fee, *i.e.*, one based on a share of capital gains on, or capital appreciation of, a client’s account when it would otherwise be prohibited by the Advisers Act, *e.g.*, when charged with respect to a fund that relies on Section 3(c)(1) under the Investment Company Act of 1940 (a “3 (c)(1) Fund”) (such fees being permitted by the Advisers Act with respect to a fund that relies on Section (c)(7) of the Investment Company Act and certain other types of clients). In relevant part, the Rule allows an adviser to charge a performance-based advisory fee to a “qualified client” who either has a threshold amount of assets under management (“AUM”) with the adviser or meets a net worth test. (The Rule also provides that a “qualified purchaser” under the Investment Company Act is a qualified client.) The Amendments codify a July 12, 2011 SEC order setting those amounts at \$1 million and \$2 million, respectively, and effect a related mandate under the Dodd-Frank Act by providing that the SEC will issue an order every five years that adjusts the AUM and net worth tests for inflation. The Amendments also (a) exclude the value of a primary residence, and related debt up to the current market value of the residence, from the qualified client net worth calculation and (b) revise the Rule’s transition provision to create grandfather provisions that address changes in the Rule’s conditions and performance-based fee arrangements entered into prior to an adviser’s registration with the SEC.

AUM and Net Worth Tests. The Dodd-Frank Act required the SEC to revise the dollar amounts used in the Rule by July 21, 2011 and to do so every five years thereafter to adjust for the effects of inflation. The SEC will make these adjustments using a formula based on the Personal Consumption Expenditures Chain-Type Price Index, or its successors, published by the United States Department of Commerce. In calculating a client’s AUM, an adviser may include amounts the client has made a bona fide contractual commitment to invest in the adviser’s private funds, provided the adviser has a reasonable belief the commitment will be met.

Primary Residence and Related Debt. Although not required to do so by the Dodd-Frank Act, the SEC has revised the Rule to exclude from the qualified client net worth calculation the fair market value of a primary residence and the amount of debt secured by the property not to exceed the property’s value; the amount of related debt in excess of the property’s value is included as a liability in the net worth calculation. This modification to Rule 205-3 resembles the exclusion of the value of a primary residence and related debt from the net worth calculation adopted by the SEC for purposes of the “accredited investor” definitions in Rules 215 and 501 under the Securities Act of 1933 (as discussed in the [January 10, 2012 Financial Services Alert](#)). Mirroring the amended “accredited investor” definitions, the Amendments also include an exception under which any increase in the amount of debt secured by a primary residence, other than in connection with its purchase, in the 60 days before an advisory contract is entered into must be included as a liability in the net worth calculation, even if the estimated value of the primary residence exceeds the aggregate amount of its related debt.

Grandfathering – Future Changes in the Rule’s Conditions. Under the Amendments, compliance with the Rule’s conditions for charging a performance-based advisory fee to a client are determined based on whether the conditions in effect at the time the adviser

entered into the relationship with the client were met. Because the Rule looks through a fund that relies on Section 3(c)(1) under the Investment Company Act of 1940 (a “3(c)(1) Fund”) to treat each investor as a client, the adviser to a 3(c)(1) Fund who wishes to charge a performance-based fee must only ensure that an investor met the qualified client conditions in effect at the time of initial investment. Subsequent changes in the Rule’s AUM and net worth tests will not affect the adviser’s ability to rely on the Rule with respect to that investor.

Grandfathering - Previously Unregistered Advisers. The Amendments grandfather performance-based fee arrangements in the situation where an adviser that was not required to register with the SEC subsequently registers (a “Formerly Exempt Adviser”). Under the Amendments, a Formerly Exempt Adviser may continue to charge a performance-based fee in a client relationship that pre-dates its registration without meeting the Rule’s conditions. A Formerly Exempt Adviser will, however, need to meet the Rule’s conditions for each post-registration client charged a performance-based fee, although, as discussed above, the Rule’s conditions must only be met at the time the client entered into the relationship with the adviser. Because of the manner in which the Rule “looks through” 3(c)(1) Funds, a Formerly Exempt Adviser may disregard the Rule’s conditions as to pre-registration investors in a 3(c)(1) Fund with a performance-based fee (including as to any additional investments made post-registration), but must meet the Rule’s conditions in effect at the time of initial investment for each post-registration investor.

Certain Transfers of Interests in 3(c)(1) Funds. The Amendments include a provision that allows an interest in a 3(c)(1) Fund to be transferred from a qualified client by gift or bequest, or pursuant to an agreement related to a legal separation or divorce, to a transferee that is not a qualified client at the time of the transfer without affecting compliance with the Rule by the 3(c)(1) Fund’s adviser. The adopting release notes that the SEC took a similar approach in Rule 3c-6 under the Investment Company Act of 1940 with respect to the determination of beneficial owners following certain transfers of ownership interests in a 3(c)(1) Fund.

Effective Date. The Amendments are effective May 22, 2012.

FRB Issues Order Approving Capital One Acquisition of ING Bank; Order Expands Upon the FRB’s Analysis of Financial Stability Factor

The FRB issued an [order](#) (the “Capital One Order”) in which it approved Capital One Financial Corporation’s (“Capital One”) acquisition of ING Bank, fsb (“ING Bank”), a large, internet-based depository institution. The Dodd-Frank Act amended the Bank Holding Company Act to require that the FRB consider whether a proposed acquisition would pose a “risk to the stability of the United States banking or financial system.” The Capital One Order is the second FRB decision that has addressed the FRB’s financial stability analysis. The first FRB decision that applied the FRB’s financial stability analysis was the FRB’s approval of PNC Financial Services Group, Inc.’s acquisition of RBC Bank (USA) (the “PNC Order”), which was described in the [January 10, 2012 Financial Services Alert](#).

The Capital One Order uses the same financial stability factors that the FRB used in the PNC Order. The Capital One Order, however, provides additional detail on how the FRB

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evaluates the individual factors and provides guidance on types of transactions that would not be likely to present financial stability concerns.

Some key guidance provided by the FRB in the Capital One Order is that large size may, of itself, be a factor that could cause the FRB to deny an acquisition application. The FRB also states that transactions likely to have only a “*de minimis* impact on an institution’s systemic footprint” would not be likely to raise financial stability concerns, and the FRB provided three examples in the Capital One Order of such *de minimis* transactions: (1) an acquisition of less than \$2 billion of assets; (2) a transaction resulting in a firm with less than \$25 billion in total assets; and (3) a corporate reorganization. It is useful to note that in the Capital One Order the FRB found that neither Capital One nor ING was engaged in the type of complex financial activities that would have further complicated the FRB’s analysis of risks to the financial system posed by the transaction.