

Corporate Governance Update

NOVEMBER 2006

REGULATORY RELIEF BILL SIGNED INTO LAW

The President has signed S. 2856, the Financial Services Regulatory Relief Act of 2006 (Regulatory Relief Act) into law. The bill's passage will set in motion a variety of provisions impacting financial institution management. Highlights of the Regulatory Relief Act include a coordinated effort to promulgate joint regulations implementing the "push-out" provisions of the Gramm-Leach-Bliley Act (GLBA), adaptations in both interest on reserves and reserve ratio flexibility, and leeway on director election methods, among other things.

One of the major impacts of the Regulatory Relief Act is the mandate for the SEC and the other federal regulatory agencies to work together to iron out activity-specific exceptions to the definition of "broker" under Section 201 of the GLBA. Section 101 of the Regulatory Relief Act fortifies the banking regulators with a clear-cut rule that these new regulations will supersede those previously issued by the SEC. The SEC and the FRB are required to issue joint proposed rules within 180 days of enactment; however, they must seek the concurrence of the other federal banking agencies prior to adopting the final rules.

Sections 201 and 202 of the Regulatory Relief Act authorize the payment of interest on reserve balances held by depository institutions and eliminate the eight percent floor on transaction deposit reserves, respectively. Section 201 authorizes interest reserve payments subject to the limits on short-term rates generally. This may have the effect of reducing the need for costly sweep accounts currently in place for that purpose. Section 202 would enhance flexibility in setting the ratio of reserves maintained against transaction accounts, potentially allowing a zero reserve ratio.

Two other provisions of the Regulatory Relief Act offer national banks increased management discretion. Section 301 permits national banks to eliminate cumulative voting. And subject to safety and soundness considerations, Section 302 simplifies the calculation requirements for paying dividends; however, it maintains the requirement for

regulatory approval on dividends exceeding a threshold amount.

While many of the provisions in the Regulatory Relief Act have effective dates in the distant horizon (October 2011, in some cases), financial institutions are advised to become familiar with the requirements and assess how they will implement them. For further information call the firm's Corporate Practice Group. Also, we will be providing a more detailed analysis at the November Bankers' Compliance Group chapter meeting.

SEC AMENDS DEFINITION OF INDEPENDENT DIRECTOR

A recent SEC release (Release No. 34-54583; File No. SR-NASDAQ-2006-021) modified some of NASDAQ's corporate governance standards, including the definition of "independent director." NASDAQ had filed a proposed rule on July 28, 2006 (later revised with a new request for comments) to amend NASDAQ Rules 4200(a)(15), IM-4200 and 4350 pertaining to its corporate governance standards for listed companies. The proposed rule, as amended in 71 FR 50955, was approved by the SEC, and aligns the NASDAQ rules on director independence with the corresponding NYSE rule.

In particular, the rule precludes a finding of independence if a director accepts any compensation from the company or its affiliates in excess of \$60,000 during any consecutive 12-month period within the three years prior to the independence determination. Under current NASDAQ Rule 4200(a)(15)(B), a director of a listed company would not be considered independent if the director or a family member of the director has accepted more than \$60,000 in *payments* during the three-year "look back" period. This rule change amends the rule to refer to *compensation* in excess of \$60,000 from the company based on NASDAQ's belief that compensation – rather than payments in general – more directly bears upon a director's independence. The rule distinguishes those payments considered non-compensatory, *e.g.*, interest related to banking services,

insurance proceeds and non-preferential loans from financial institutions from those which could be considered indirect compensation, *e.g.*, payments made by the company for the benefit of the director – such as political contributions to the campaign of a director or a family member and loans to a director or family member that are on terms not generally available to the public.

The new rule also revised various other provisions of NASDAQ's corporate governance standards to conform more closely with the NYSE's corporate governance standards for its listed issuers. These other changes relate to: the status of independent directors who serve as interim officers for a maximum period of one year; the definition of "non-executive employee"; inclusion of parent and subsidiary within the meaning of "company"; and an exception in NASDAQ's standards relating to audit committees for certain issuers that have a listed parent.

NASDAQ plans to implement the rule change immediately; however, to facilitate the transition to the new rules, a director considered independent under the prior rules may continue to serve on the issuer's board of directors for up to 90 days after the rule's filing. The SEC notes that this transition period does not affect an issuer's obligation to comply with the requirements of Rule 10A-3 under the Act relating to audit committees.

FDIC ISSUES SHORT-TERM DIVIDEND RULE

The FDIC has issued a final rule (FIL-92-2006) to implement Assessment Dividends, as required by the Federal Deposit Insurance Reform Act of 2005. The Reform Act generally requires that the FDIC pay dividends from the Deposit Insurance Fund (DIF) to insured institutions when the DIF reserve ratio at the end of a calendar year exceeds 1.35 percent. The final rule, which takes effect on January 1, 2007:

- Establishes a temporary rule for payment of dividends from the DIF. The rule expires at the end of 2008; and
- Indicates the FDIC's intention to undertake a second, more comprehensive rulemaking on dividends to explore alternative methods for distributing future dividends after the initial two-year period.

The FDIC considers it unlikely that the reserve ratio with the DIF will trigger a dividend before this temporary rule expires.

FOR ADDITIONAL INFORMATION...

If you have questions, please contact Mark Aldrich or Peter Warren of Aldrich & Bonnefin.