

Financial Services Advisory Update

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SEC Will Not Appeal Vacation of Advisers Act Broker-Dealer Exemption

As reported in the April 2007 FSAU, the US Court of Appeals for the District of Columbia vacated Rule 202(a)(11)-1 under the Investment Advisers Act of 1940, which had exempted certain broker-dealers providing fee-based brokerage accounts from registering as investment advisers under the Advisers Act, finding that the SEC had exceeded its statutory authority in adopting the rule. In what has been described as a major blow to the brokerage industry, the SEC announced on May 14 that it will not appeal the controversial decision. The SEC's decision comes just days after SEC Commissioner Paul Atkins stated that the SEC would be "well justified" to ask for a rehearing. Due to the operational difficulties caused by the vacation of the rule, the SEC asked the court to grant a four-month stay of its March 30 decision to allow investors and their brokers to implement changes in the accounts affected.

On May 14, 2007 the Securities Industry and Financial Markets Association (SIFMA), which represents the brokerage industry, issued a press release opposing the SEC's decision not to seek a rehearing, expressing "outrage" at the decision. SIFMA maintains that a rehearing would be beneficial because the court did not address public policy concerns or the merits of fee-based brokerage accounts. According to SIFMA, applying the Advisers Act to broker-dealers is duplicative because they are already subject to extensive regulation under the Securities Exchange Act of 1934 and SRO rules. SIFMA argues that the one million investors

who utilize the fee-based brokerage method will be disadvantaged by the ruling. Investors that currently have fee-based brokerage accounts are now forced to find alternative types of accounts. Eliminating the availability of fee-based accounts could lead to investors being enrolled in commission-based accounts resulting in increased costs compared to those in a fee-based brokerage accounts, where annual fees average one percent of total assets. Many firms have also reported to SIFMA that the SEC request of four months to respond to the ruling is insufficient due to the number of accounts and logistics involved.

The reaction to the SEC decision not to appeal has been varied among brokerage firms. Some firms have begun to shut down their fee-based brokerage programs. Several major firms reportedly have advised their brokers not to open any more of these accounts and are discussing alternatives to the fee-based brokerage programs to cater to the investment needs of their clients. Other firms are refusing to alter their financial strategies and have advised their brokers to continue using the full range of services that make sense for their clients.

The SEC has said that it will consider whether additional rulemaking or interpretation is necessary regarding the application of the Advisers Act to these accounts and other issues resulting from the court's decision.

Gregory P. Gnall, William Bave



Editors' Note

The White & Case LLP FINANCIAL SERVICES ADVISORY UPDATE alerts you to developments in the financial services field, including legislation, regulations, judicial decisions, policy statements and significant government agency issuances.

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US Court Rules Maritime Law Preempts UCC

On April 24, 2007, a federal district court in the Southern District of New York held that an electronic fund transfer, or EFT, through an intermediary bank in New York can be subject to an attachment pursuant to federal maritime law, even if such attachment conflicts with New York state law regarding funds transfers. In *Navalmar (UK) Ltd. v. Welspun Gujarat Stahl Rohren Ltd.*, Judge Alvin K. Hellerstein denied defendant WGSR's motion to vacate the attachment of an EFT originated by WGSR that was attached while passing through intermediary bank, Citibank, N.A., for onward transmission to a third party. In a funds transfer, an intermediary bank is merely one bank in the chain between the bank that originated the funds transfer and the bank of the beneficiary of the transfer to whose account the funds ultimately will be credited. The intermediary bank has no other function in a funds transfer except to move the funds along to another bank, be it another intermediary bank or the beneficiary's bank. This decision is an important ruling regarding the mechanics of attaching EFTs through the use of maritime liens, thousands of which are served annually on banks in New York, particularly the major banks with international operations that are often intermediaries for transactions requiring payment in US dollars.

The basis for the dispute in this case was damage allegedly done to cargo owned by WGSR after a February 2005 voyage on a vessel owned by plaintiff Navalmar and chartered by WGSR. Navalmar secured an interim award at a subsequent arbitration in London, and after WGSR declined to pay that award, Navalmar sought and was granted an order of attachment in the Southern District. On February 2, 2007, two weeks after Navalmar initially served the order on Citibank, the bank attached the requisite amount of an EFT made at WGSR's order. Citibank, acting as an intermediary bank for a payment to be made in US dollars, had received the EFT for onward transmission.

The major issue raised on the motion to vacate the attachment was a conflict between the US Rules of Civil Procedure governing admiralty and maritime claims, which have been interpreted as permitting attachment of EFTs as they pass through intermediary banks, and section 4A-502 of the Uniform Commercial Code (UCC) as adopted in New York, which governs EFTs and provides that a bank is not obliged to act on any attachment order with respect to funds in a transfer for which it is acting as an intermediary bank.

Judge Hellerstein held that the "federal interest in maintaining the 'proper harmony and uniformity' of maritime law" preempted "any contradictory interest of New York law." The court further stated that it would not necessarily have followed the New York state statute even in the absence of preemption, arguing that the UCC departs here from common law conceptions of property, and that although clearing banks' only had brief possession of the EFT funds, they had possession nonetheless.

This ruling is one in a series of recent decisions governing the application of maritime writs of attachment to EFTs through intermediary banks that ignores UCC Article 4A's goal of providing uniform and exclusive rules on the rights, duties and liabilities of parties involved in funds transfers.

Kathleen A. Scott, Seiji Niwa

House Adopts Measure to Bar Commercial Ownership of ILCs

The US House of Representatives on May 21 easily passed HR 698, a bill that would impose strict limits on the ownership of industrial loan companies (ILCs) by commercial firms. ILCs are specialized state-chartered banks that can exercise many of the same lending powers as federally insured banks but generally cannot accept demand deposits. The legislation, titled the Industrial Bank Holding Company Act of 2007, generally would prohibit any commercial firm (defined as a firm that derives more than 15 percent of annual consolidated gross revenues from activities that are not financial in nature) from acquiring or establishing an ILC. The bill was adopted by a vote of 371 to 16.

The issue of ownership of ILCs by commercial firms attracted the attention of Congress following applications by large retailers Wal-Mart and Home Depot to acquire ILCs, when critics claimed that ILC ownership by such commercial giants would pose a threat to the integrity of the US banking system and put pressure on the federal deposit insurance safety net. Because of the controversy surrounding these and other applications by commercial firms, the FDIC imposed a moratorium on approving any new ILC applications until January 31, 2008.

H.R. 698 would grandfather certain existing ILCs currently owned by commercial firms, but such ILCs would be subject to restrictions in a number of areas, including interstate branching and expansions of business activities. The bill would also require companies that own ILCs to register with, and be subject to, consolidated supervision and examination by, the FDIC, with exceptions for companies that already are bank holding companies, savings and loan holding companies, or brokerage firms that are regulated on a consolidated basis by the SEC. In addition, the legislation would give the Federal Reserve Board authority to determine if a foreign bank meets comprehensive home-country supervision standards necessary to acquire or establish an ILC. For foreign savings and loan holding companies seeking to form or purchase an ILC, the Federal Reserve Board and the Office of Thrift Supervision would have joint authority to make such determination.

The legislation now moves to the US Senate, where, despite strong support in the House, its fate is far from certain. While a virtually identical ILC bill has been introduced in the Senate, the Senate Banking

Committee has not yet taken up the bill, and Senator Christopher Dodd, the committee's chairman, has given no indication as to when the committee might do so. Also, Senator Robert Bennett of Utah, a strong proponent of his home state's ILC industry and second-ranking Republican on the Banking Committee, could oppose the bill. In addition, a number of important issues, including exemptions to permit ILC ownership by US automakers, remain to be resolved.

The text of the HR 698 can be found at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h698rfs.txt.pdf.

Alan W. Avery

US AML Strategy Sets Ambitious Goals

On May 3, 2007, the US Departments of Treasury, Justice and Homeland Security issued the 2007 National Money Laundering Strategy (NMLS). The NMLS sets several sweeping goals to further the United States AML efforts. It was developed in response to the December 2005 interagency Money Laundering Threat Assessment, which analyzed 13 different money laundering methods ranging from long-used techniques such as smuggling of bulk cash to newer methods such as use of stored value cards which are used by consumers for legitimate reasons and criminals for illegal activities.

The NMLS identifies nine goals:

- Continue to Safeguard the Banking System
- Enhance Financial Transparency in Money Services Businesses
- Stem the Flow of Illicit Bulk Cash out of the United States
- Attack Trade-Based Money Laundering at Home and Abroad
- Promote Transparency in the Ownership of Legal Entities
- Examine Anti-Money Laundering Regulatory Oversight and Enforcement at Casinos
- Implement and Enforce Anti-Money Laundering Regulations for the Insurance Industry
- Support Global Anti-Money Laundering Capacity Building and Enforcement Efforts
- Improve How We Measure Our Progress

Each of the goals is accompanied by a discussion of threats and underlying vulnerabilities showing a need for the goal, as well as specific strategies and action items needed to achieve it. Many of the strategies and action items focus on improved outreach to the financial community, increased information-sharing among federal, state and international regulators and law enforcement, more sophisticated analysis of information derived from AML regulatory filings and investigations, additional regulation where necessary to combat new methods of money laundering and a more effective means of measuring the progress the United States has made in its AML programs.

The NMLS, which includes a copy of the 2005 Threat Assessment, may be accessed at <http://www.treas.gov/press/releases/docs/nmls.pdf>.

Kathleen A. Scott

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MAY 2007 | 02519