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SEC/CORPORATE

SEC Announces New Division of Risk, Strategy, and Financial Innovation

On September 16, the Securities and Exchange Commission announced the establishment of the Division of Risk, Strategy, and Financial Innovation. SEC Chairman Mary Schapiro also announced that University of Texas School of Law Professor Henry T.C. Hu will serve as the first director of the newly created division.

The Division of Risk, Strategy, and Financial Innovation combines the Office of Economic Analysis (OEA) and the Office of Risk Assessment (ORA) and will have three broad responsibilities: risk and economic analysis, strategic research and financial innovation. The new division will perform all of the functions previously performed by the OEA and ORA as well as the following: (i) strategic and long-term analysis; (ii) identifying new developments and trends in financial markets and systemic risk; (iii) making recommendations as to how these new developments and trends affect the SEC's regulatory activities; (iv) conducting research and analysis in furtherance and support of the functions of the SEC and its divisions and offices; and (v) providing training on new developments and trends and other matters.

According to Chairman Schapiro, this new division will provide integrated economic, legal and financial analysis in an effort to “enhance [the SEC's] capabilities and help identify developing risks and trends in the financial markets.”

SEC Issues Updated Compliance and Disclosure Interpretations

On September 14, the Securities and Exchange Commission's Division of Corporation Finance issued new and updated Compliance and Disclosure Interpretations (C&DIs) of sections, rules and regulations under the Securities Act of 1933 and the Securities Exchange Act of 1934. The current changes were focused on Sections 13(d) and 13(g) of the Exchange Act and Regulation 13D-G, where the SEC reordered and revised prior telephone interpretations and added new interpretations. The SEC's new guidance included the following:

- The SEC clarified that in a merger where a shareholder of the target acquires at least 5% of the acquiring company in a stock-for-stock exchange, the reporting exemption provided in Section 13(d)(6)(A) of the Exchange Act does not apply, and the shareholder must file a Schedule 13D or 13G, as applicable.
- The SEC affirmed that a shareholder's lack of intent to acquire more than 5% of a class of securities (for example, if the shareholder's broker mistakenly acquires at least 5% of a company's shares against the shareholder's orders) does not exempt the shareholder from its requirement to file a Schedule 13D or 13G, as applicable.
- Because directors and officers have the ability to directly or indirectly influence a company's management and policies, the SEC clarified that directors and officers would most likely not be eligible to file on Schedule 13G pursuant to Rule 13d-1(c).
- The SEC affirmed that a Schedule 13D must be filed within 10 days after the trade date, and not the settlement date, of the acquisition that creates the reporting obligation.
- The SEC confirmed that if a shareholder becomes a 5% beneficial owner due solely to a change in the issuer's outstanding securities, it has an obligation to file a report, but may do so on Schedule 13G (unless the shareholder influences or controls the change in such outstanding securities, in which event the shareholder would be required to file a Schedule 13D).
- The SEC stated that curing a failure to file a timely amendment to Schedule 13D will not affect whether the filer is liable under federal securities laws.
- The SEC stated that individual Schedule 13D filers must amend their respective Schedule 13Ds upon formation of a group.
- The SEC provided guidance that if a holder holds preferred securities convertible into more than 5% of a registered class of securities, but the conversion terms limit conversion into 5% or more of such class, the holder may not be obligated to file a beneficial ownership report if such conversion terms are binding and valid, according to SEC standards.
- The SEC stated that the disclosures in any initial or amended Schedule 13D should reflect ownership as of the date of the report, and not the date of the event requiring filing of the report.
- The SEC confirmed that a Schedule 13D filer must promptly amend its filings upon any change in its plans with respect to its holdings, even if such plans have not yet been disclosed to the issuer or its management.

- The SEC commented that a Schedule 13D filer may not include in its filings statements that oppose management, its proposals or a pending transaction without also considering whether such statements constitute solicitation materials and require disclosure under Regulation 14A.
- The SEC stated that a Schedule 13D filer may include on one Schedule 13D all open-market purchases or sales on the same day within a $1 price range; it does not need to include such transactions on separate Schedule 13Ds.

Click here to view the new C&DIs with respect to Sections 13(d) and 13(g) of the Exchange Act and Regulation 13D-G.
Click here to view the complete C&DIs.

BROKER DEALER

FINRA Amends Interpositioning Standards under Rule 2320

On September 8, the Securities and Exchange Commission approved a Financial Industry Regulatory Authority proposed rule change to National Association of Securities Dealers Rule 2320, which governs members' best execution and interpositioning obligations. Under Rule 2320(a)'s best execution standards, when executing customer transactions, a member must use reasonable diligence to ascertain the best market for the subject security so the resulting price to the customer is as favorable as possible under prevailing market conditions. With the rule change, Rule 2320(a)'s best execution standards will apply to the interpositioning of a third party between the member and the best available market for a security, which is governed by Rule 2320(b). The Release reminds members that customer cost will remain a crucial factor in determining whether a member has fulfilled its best execution obligations under Rule 2320, including transactions involving interposed third parties.

Click here to read SEC Release No. 34-60635.

SEC Approves Amendments Requiring Related Market Center Indicator in Non-Tape Reports Submitted to FINRA

The Financial Industry Regulatory Authority has issued Regulatory Notice 09-54 discussing trade reporting rule amendments recently approved by the Securities and Exchange Commission. Effective March 1, 2010, firms submitting a non-tape report to the Alternative Display Facility, a Trade Reporting Facility or the OTC Reporting Facility (collectively, FINRA Facilities) associated with a previously executed trade that was not reported to that same FINRA Facility must identify the facility or market where the associated trade was reported for dissemination purposes (Related Market Center). In addition, firms are required to retain and produce to FINRA, upon request, documentation relating to the associated trade. Firms will have until the end of the day on the trade date to submit non-tape reports with the required Related Market Center information, unless a shorter reporting time is required under other FINRA rules. The Notice also provides guidance to assist firms in populating the Related Market Center field in specific reporting scenarios.

Click here to read FINRA Regulatory Notice 09-54.

SEC to Hold Securities Lending and Short Sale Roundtable

On September 29 and 30, the Securities and Exchange Commission will hold a roundtable discussing issues relating to securities lending and short sales. The roundtable will review securities lending practices in-depth and will also analyze possible short sale pre-borrowing requirements and additional disclosures.

Click here to read the SEC press release, which links to the agenda for the roundtable.

PRIVATE INVESTMENT FUNDS

SEC and FSA to Cooperate on Hedge Fund Regulatory Requirements

Securities and Exchange Commission Chairman Mary Schapiro and UK Financial Services Authority (FSA) Chief Executive Officer Hector Sants announced that their respective agencies will explore common approaches to reporting and other regulatory requirements for market participants, including hedge funds and their advisors. Chairman Schapiro said, “As the regulators of two of the world's major market centers, the SEC and the FSA have a strong interest in collaborating with respect to... hedge funds.” In particular, the SEC and FSA agreed to identify a common set of data to collect from hedge fund advisors and managers to help the agencies identify regulatory risks. The announcement came out of a meeting that was part of a series of strategic dialogues between the SEC and FSA on current matters impacting U.S. and UK capital markets.

To view the SEC press release click here.

IOSCO Publishes Report on Funds of Hedge Funds Regulatory Standards

The International Organization of Securities Commissions (IOSCO) has published Elements of International Regulatory Standards on Funds of Hedge Funds Related Issues Based on Best Market Practices, which proposes standards aimed at addressing investor protection regulatory issues. The report sets forth proposals for funds of hedge funds' managers in two areas: (a) the methods by which managers should manage liquidity risk, including considering (i) whether the fund of hedge funds' level of liquidity is consistent with the underlying funds, (ii) the liquidity of the types of financial instruments held by the underlying funds, (iii) the conditions and disclosure of any limited redemption arrangements by the fund of hedge funds, and (iv) the existence of any side-letter arrangements entered into by the underlying funds; and (b) the due diligence process used by managers prior to and during investment, including (i) the due diligence elements to be monitored and analyzed, (ii) the procedures and structures funds of hedge funds' managers should have in place to carry out a proper and robust due diligence, and (iii) the conditions for outsourcing of due diligence.

To view the standards click here.

CFTC

CFTC and FSA Sign MOU on Supervision of Cross-Border Clearing Organizations

On September 14, the Commodity Futures Trading Commission and the UK Financial Services Authority (together, the Authorities) signed a Memorandum of Understanding (MOU) to enhance cooperation and the exchange of information relating to the supervision of cross-border clearing organizations.

The MOU, among other things, sets forth guidelines for information sharing between the Authorities, including notification of regulatory changes and particular adverse events affecting clearing organizations, as well as specific requests for information. It also contemplates periodic meetings between the Authorities. The MOU establishes guidelines for extra-territorial on-site visits by the Authorities and establishes standards regarding the permissible use and confidentiality of information obtained from the other Authority.

CFTC Global Markets Advisory Committee Meeting September 30

The Commodity Futures Trading Commission's Global Markets Advisory Committee will conduct a public meeting on September 30 at the CFTC's Washington, D.C., headquarters at Three Lafayette Centre, 115 21st Street NW. The meeting will run from 1 p.m. to 5 p.m. Eastern Time, and will be broadcast live via webcast at http://www.cftc.gov/.

The agenda includes updates on (i) International Organization of Security Commissions issues; (ii) discussion of bankruptcy issues related to the CFTC, the UK Financial Services Authority (FSA) and Lehman Brothers; (iii) an overview of the U.S. Treasury Department's proposal to regulate the over-the-counter (OTC) derivatives market and related legislative language concerning the CFTC; and (iv) a presentation by the FSA on OTC derivatives.

BANKING

Federal Reserve Announces Consumer Compliance Review of Nonbank Subsidiaries

On September 15, the Board of Governors of the Federal Reserve System (Federal Reserve) announced that it will implement a consumer compliance supervision program in nonbank subsidiaries of bank holding companies and foreign banking organizations with activities covered by the consumer protection laws and regulations the Federal Reserve enforces.

The Federal Reserve has the authority to examine nonbank subsidiaries for compliance with the Truth in Lending Act, Equal Credit Opportunity Act, Home Ownership and Equity Protection Act, Fair Credit Billing Act, Consumer Leasing Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, Home Mortgage Disclosure Act, Truth in Savings Act, rules promulgated pursuant to the Federal Trade Commission Act, and the Real Estate Settlement Procedures Act. According to the accompanying release, “Supervisory activities will be planned based on the issues identified in the risk assessments and through the investigation of consumer complaints. The activities will be risk-focused and will include continuous monitoring, discovery reviews, target or full-scope examinations with transaction testing, as appropriate, and the investigation of consumer complaints.”

This policy will take effect immediately.

For more information, click here.

Federal Reserve Readies Proposal to Limit Bankers' Compensation

According to reports in today's financial press, including the *Wall Street Journal*, the Federal Reserve is close to issuing a broad-based proposal to limit payment incentives for bankers. The proposal, which would apply to state-member banks subject to Federal Reserve Board supervision, reportedly will feature the use of clawbacks, and may encourage the use of stock options or restricted stock instead of other types of awards that would vest immediately. The draft proposal is intended to curb ostensibly profitable activities that can enrich employees in the short term while exposing the employer to undue risk. The proposal would not technically apply to state non-member banks, which are subject to the jurisdiction of the Federal Deposit Insurance Corporation, nor to federal savings banks, which are subject to the jurisdiction of the Office of Thrift Supervision. Nonetheless, we expect that the Federal Reserve's proposal will be studied closely and perhaps adopted by other bank regulatory agencies. We will be following the proposal as details emerge.

Treasury Announces Expiration of Guarantee Program for Money Market Funds

The U.S. Department of the Treasury today announced that the Guarantee Program for Money Market Funds will expire today. The Program was initially established for a three-month period that could be extended through September 18. Since inception, the Treasury has had no losses under the

Program and earned approximately $1.2 billion in participation fees. The Treasury designed the Program to stabilize markets after a large money market fund's announcement that its net asset value had fallen below $1 per share in September of 2008.

Please see "Residential Credit Solutions Wins Bid in Legacy Loans Program Pilot Sale" in **Structured Finance and Securitization** below.

STRUCTURED FINANCE AND SECURITIZATION

IRS Eases Rules on Modification of Securitized Commercial Mortgage Loans

On September 15, the Internal Revenue Service published Revenue Procedure 2009-45 providing that a servicer may agree to a substantial modification of any commercial mortgage loan as long as the servicer reasonably believes that there is a significant risk of default of the pre-modification loan upon maturity of the loan or at an earlier date, without thereby causing the real estate mortgage investment conduit (REMIC) or grantor trust status of a securitization vehicle to be challenged. This reasonable belief must be based on a diligent contemporaneous determination of that risk, which may take into account credible written factual representations made by the issuer of the loan if the holder or servicer neither knows nor has reason to know that such representations are false. In a determination of the significance of the risk of a default, one relevant factor is how far in the future the possible default may be, but there is no maximum period. For example, the foreseen default might be as much as one year or more in the future. Most significantly (and contrary to the IRS's understanding of the prior views of many industry participants), a servicer may reasonably believe that there is a significant risk of default even if the loan is currently performing and default is not imminent. The servicer must reasonably believe that the modified loan presents a substantially reduced risk of default, as compared with the pre-modification loan.

The revenue procedure applies to loan modifications of commercial loans effected on or after January 1, 2008.

The IRS also finalized long-anticipated regulations easing the restrictions on modifications of performing commercial mortgage loans held in a REMIC. We will further describe these and related developments in a special *Client Advisory*.

Click here to read Revenue Procedure 2009-45.

Residential Credit Solutions Wins Bid in Legacy Loans Program Pilot Sale

The Federal Deposit Insurance Corporation (FDIC) announced that Residential Credit Solutions was the winning bidder in a pilot sale of receivership assets conducted to test the funding mechanism for the Legacy Loans Program. The FDIC, as a receiver of Franklin Bank, SSB, owns a portfolio of residential mortgage loans with an unpaid principal balance of approximately $1.3 billion, which the FDIC will convey to a limited liability company. Residential Credit Solutions will pay $64,215,000 in cash for a 50% stake in the limited liability company using 6-to-1 leverage. The limited liability company will issue a note of $727,770,000, guaranteed by the FDIC in its corporate capacity, to the FDIC as receiver. The FDIC determined that this bid, whose present value equaled 70.63% of the outstanding principal balance of the portfolio, would result in the greatest return for the receivership. After the closing, which is expected to take place later this month, Residential Credit Solutions will manage the portfolio and service the loans under Home Affordable Modification Program guidelines. The FDIC anticipates that it will sell the note at a future date.

The Legacy Loans Program is part of the Public-Private Investment Program, announced in March by the Secretary of the Treasury, the Federal Reserve and the FDIC, which is being developed to help banks remove troubled assets from their balance sheets. The pilot sale was conducted as a part of the development of the Legacy Loans Program to test the funding mechanism. A total of 12 consortiums made bids to purchase ownership interests in the limited liability company in a sale involving financing offered by the receivership to the limited liability company with an amortizing note guaranteed by the FDIC. Bidders were given the chance to bid two different leverage options, 6-to-1 or 4-to-1, or to submit a cash bid. The FDIC will analyze the results of this pilot sale to determine whether the Legacy Loans Program can be used to remove troubled assets from the balance sheets of banks and, in turn, enable banks to raise new capital and spur lending to further economic recovery in the United States.

Read more.

ANTITRUST

Undisclosed Smart Card Patent May Be Unenforceable and Constitute Monopolization

A series of antitrust cases has arisen over the last ten years in the context of standard setting, where a party who participates in a standard-setting process has a patent that is infringed by the standard but does not disclose that patent until after the standard is adopted in the marketplace. This activity, referred to as a “patent ambush,” has been the subject of a number of Federal Trade Commission actions and private litigations in which an alleged infringer attacks the enforceability of the patent at issue and claims the patent owner violated the antitrust laws via the nondisclosure. Companies participating in standard-setting organizations (SSOs) that require disclosure of relevant patents should be cognizant that any nondisclosure, even if not done deceptively, may lead to the loss of patent enforceability. Deceptive nondisclosure may additionally lead to antitrust liability.

A ruling out of a federal court in California last week in the case of *ActivIdentity Corp. v. Intercede Group PLC* illustrates this risk. ActivIdentity is a member of an SSO that developed a standard for remote application management of smart cards. ActivIdentity also holds a patent that covers technologies for remotely updating smart cards under the SSO's standard. It sued Intercede for infringing its patent by using the standard. Intercede then filed patent unenforceability and antitrust counterclaims, alleging that ActiveIdentity had an obligation to disclose its patent before the SSO developed standards that the patent might read on, and that ActivIdentity failed to make that required disclosure.

The court cited the Federal Circuit's 2008 decision in *Qualcomm Inc. v. Broadcom Corp.* and explained that "[a] claim for unenforceability can be based on a patent owner's waiver due to failure to disclose its patent rights to an SSO." Importantly, the court noted that the nondisclosure need not be fraudulent. The court also cited the D.C. Circuit's 2008 decision in F.T.C. v. Rambus for the rule that a monopolization claim based on failure to disclose to an SSO must allege that the failure to disclose was deceptive and that but for the nondisclosure the SSO would have developed a different standard. The court found that Intercede had alleged sufficient facts on these elements to sustain its counterclaims. (*ActivIdentity Corp. v. Intercede Group PLC*, No. 08-4577, slip op. (N.D. Cal. Sept. 11, 2009))

UK DEVELOPMENTS

FSA Enforcement Director Speaks on Prosecutorial Approach

On September 14, the UK Financial Services Authority (FSA) published the text of a speech by Margaret Cole, FSA Director of Enforcement, about the FSA's strategy and approach to fighting fraud.

Ms. Cole explained that historically the FSA had used its prosecution powers sparingly. That has changed; it is now committed to a tough stance on markets offenses. It is determined to be a "feared and respected prosecutor" of insider dealing and unauthorized business fraud.

The FSA will increasingly use its criminal powers against insider dealing and in relation to fraud by investment businesses which do not have FSA authorization, rather than proceeding for civil penalties.

Please see "SEC and FSA to Cooperate on Hedge Fund Regulatory Requirements" in **Private Investment Funds** above.

EU DEVELOPMENTS

UK Financial Services Minister Criticizes Draft AIFM Directive

On September 11, HM Treasury released the text of a hard-hitting speech by Lord Myners, Financial Services Secretary to HM Treasury, on the draft EU Alternative Investment Fund Managers Directive (Draft Directive).

Lord Myners, in criticizing the Draft Directive, said, "[I]mposing ill-considered rules in haste is counterproductive, whether at European or national level." Lord Myners emphasized that the UK "is not in the business of blocking more stringent regulation and effective supervision." He continued: "We must not be beguiled by protectionism hiding as though it were protection. Hedge funds and private equity have not been central to the financial crisis." He commented on the success of UK hedge fund regulation and noted the failure of the European Commission to consult on the Draft Directive. Lord Myners also said that the UK would work hard to achieve a directive "that allows efficient, well run and well regulated fund managers to compete for business without restriction across the EU and to make the EU a base from which to compete in global markets. But current proposals need remedying before this can be delivered."

In response to points made by critics who said that the Draft Directive did not go far enough to address certain issues, Lord Myners commented that the Draft Directive was not the right place to address short selling or tax avoidance.

Consultation on EU Communication on Financial Supervision

On September 15, the European Commission published a summary of the responses it has received to the public consultation on its Communication on Financial Supervision dated May 27 (the Communication), together with those responses which were authorized for publication .

The Communication sets out proposals for a new European financial supervisory framework based on the recommendations in the de Larosière report. Respondents generally welcomed the proposals set out in the Communication and broadly supported its conclusions.

CONTACTS

For more information, contact your Katten attorney or any of the following attorneys.

Christina J. Grigorian
+1.202.625.3541
christina.grigorian@katten.com

Laura Keidan Martin
+1.312.902.5487
laura.martin@katten.com

Jonathan D. Weiner
+1.212.940.6349
jonathan.weiner@katten.com