Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

April 1, 2011

SEC/CORPORATE

SEC Proposes Rules Implementing Dodd-Frank Requirements Relating to Compensation Committees and Their Consultants and Advisers

On March 30, the Securities and Exchange Commission proposed rules directing the national securities exchanges to adopt listing standards related to the compensation committees of listed companies and their consultants and advisers, as required by Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 10C to the Securities Exchange Act of 1934. As with all listing standards, the exchanges would need the approval of the SEC prior their adoption.

Proposed Rule 10C-1(b)(i) would direct the exchanges to adopt listing standards that would require each member of a company's compensation committee, or any other committee that oversees executive compensation, to be board members and to be independent. Proposed Rule 10C-1(b)(1)(ii) would require the exchanges to develop a definition of independence after considering relevant factors, including the source of a director's compensation, any consulting, advisory or other compensatory fee paid by the issuer to such director, and whether the director is affiliated with the issuer, one of its subsidiaries, or an affiliate of a subsidiary. Proposed Rule 10C-1(a)(3) would provide that the exchanges' listing standards may provide for a cure period if a member of a compensation committee ceases to be independent for reasons that are out of such person's control. Controlled companies, limited partnerships, companies in bankruptcy proceedings, open-ended management investment companies registered under the Investment Company Act of 1940 and any foreign private issuer that discloses in its annual report the reasons that it does not have an independent compensation committee would each be exempted from the compensation committee independence listing standards under proposed Rule 10C-1(b)(iii).

Proposed Rules 10C-1(b)(2) and 10C-1(b)(3) would direct the exchanges to adopt listing standards providing that compensation committees may obtain the advice of a compensation consultant, independent legal counsel or other adviser and shall be directly responsible for appointing, paying and overseeing their outside advisers. Listed issuers would also be required to provide funds for any such adviser. Proposed Rule 10C-1(b)(4) would require the exchanges to adopt a listing rule that provides that a compensation committee must consider the following factors when selecting a compensation adviser:

- whether the consulting company employing the compensation adviser is providing any other services to the company;
- how much the consulting company that employs the compensation adviser has received in fees from the company, expressed as a percentage of its total revenue;
- what policies and procedures have been adopted by the consulting company employing the compensation adviser to prevent conflicts of interest;
- whether the compensation adviser has any business or personal relationship with a member of the compensation committee; and
- whether the compensation adviser owns any stock of the issuer.

The proposed rules would also amend Item 407(e)(3)(iii) of Regulation S-K to require an issuer to disclose in its proxy statement whether (1) its compensation committee has retained or obtained the advice of a compensation

consultant or (2) the work of a compensation consultant has raised any conflict of interest, and, if so, the nature of such conflict and how it is being addressed. The proposed amendments to Item 407(e)(3)(iii) would eliminate the current disclosure exception for services that are limited to consulting on any broad-based plans and the provision of information that is not customized for the issuer. However, the exception has been retained for purposes of fee disclosure requirements.

Read more.

BROKER DEALER

FINRA Clarifies Obligations and Supervisory Responsibilities for Functions Outsourced to Third-Party Service Providers

The Financial Industry Regulatory Authority is requesting comment on a proposed new rule clarifying the scope of a member firm's obligations and supervisory responsibilities for functions or activities outsourced to a third-party service provider. According to FINRA, new Rule 3190 (Use of Third-Party Service Providers) addresses continued requests from its member firms for FINRA to identify specific functions that a clearing or carrying member firm may outsource to a third-party service provider and the appropriateness of any member firm outsourcing activities to a third-party service provider that is not registered as a broker-dealer.

Proposed Rule 3190 makes clear that outsourcing functions of a broker-dealer to a third-party service provider does not relieve the member firm of its obligation to comply with applicable securities laws and regulations. Moreover, a member firm cannot delegate its responsibilities for, or control over, any outsourced functions.

The proposed rules also require that a member firm maintain supervisory procedures, including due diligence measures, "reasonably designed" to ensure that third-party service provider arrangements achieve compliance with applicable securities laws and regulations. There are additional restrictions and obligations contained in the proposed rule that apply solely to clearing and carrying member firms and third-party service provider arrangements. Comments on Proposed Rule 3190 are due by May 13.

Click here to read Regulatory Notice 11-14, issued by FINRA in March.

FINANCIAL MARKETS

Financial Stability Oversight Council Proposes Rules Regarding Designation of Financial Market Utilities as Systemically Important

The Financial Stability Oversight Council (FSOC) has released proposed rules regarding the criteria under which it will designate certain financial market utilities (FMUs) as "systemically important."

The Dodd-Frank Wall Street Reform and Consumer Protection Act defines an FMU generally as any person that manages or operates a multilateral system for the purposes of transferring, clearing or settling payments, securities, or other financial transactions among financial institutions or between a financial institution and that person.

The Dodd-Frank Act gives the FSOC the ability to designate an FMU as systemically important, and therefore subject to Title VIII of the Dodd-Frank Act. FMUs subject to Title VIII may, upon the determination of the Board of Governors of the Federal Reserve, the Commodity Futures Trading Commission and the Securities and Exchange Commission, in consultation with the other members of the FSOC, be subject to heightened risk management standards and additional examinations, enforcement actions and reporting requirements. The Federal Reserve may further determine that systemically important FMUs are eligible to maintain an account with, and receive additional services from, the Federal Reserve.

The proposed rules set out a general framework within which the FSOC will evaluate potential systemically important FMUs. The evaluation will generally be centered around the considerations mandated by the Dodd-Frank Act, including (1) the aggregate monetary value of transactions processed by the FMU; (2) the aggregate exposure of the FMU to its counterparties; (3) the relationships, interdependencies, or other interactions of the FMU with other FMUs; (4) the effect that the failure or disruption of the FMU would have on critical markets,

financial institutions or the broader financial system; and (5) any other factors the FSOC deems appropriate. The FSOC indicates in the release accompanying the proposed rules that, while it intends to undertake evaluations in as objective and consistent manner as possible, it recognizes that different factors may warrant different weights with respect to different FMUs, and that evaluations will be made on a case-by-case basis. The FSOC also indicates that it anticipates undertaking evaluations in a two-stage process, and that an FMU will receive prior notice of a proposed determination that it is systemically important and will have the opportunity to appeal any such determination before it becomes effective.

The FSOC has indicated that it intends to permit FMUs to submit written materials in support of or in opposition to the proposed designation of the FMU as systemically important during the evaluation process. The proposed rules also would permit the FSOC, subject to certain standards of reasonableness, to require any FMU to submit information that the FSOC may require in its evaluation.

The FSOC is requesting comments on all aspects of its proposed rules. The comment period will close on May 27.

A copy of the proposed rules can be found here.

CFTC

Options Clearing Corporation Proposes Internal Cross-Margining Program for Market Professionals

The Options Clearing Corporation (OCC) has submitted a petition to the Commodity Futures Trading Commission to permit OCC to operate an internal non-proprietary cross-margining program available to market professionals who trade futures products and securities products that are cleared by OCC in its capacity as a derivatives clearing organization and a securities clearing agency, respectively.

The CFTC requires that cross-margined futures and securities positions that are cleared solely by OCC be cleared by the same clearing member. OCC is requesting a modification to permit internal non-proprietary cross-margining accounts to be maintained at OCC jointly by a pair of affiliated clearing members, each of which is dually registered as a futures commission merchant and a securities broker-dealer.

The CFTC is requesting comments on this proposed change. The comment period will close on April 22.

OCC's request can be found here.

LITIGATION

Video Game Company Shareholder Class Action Suit Dismissed

Shareholders of The9, Ltd., which operates online video games in China, filed a class action against the company and certain of its current and former officers for violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, alleging that defendants fraudulently misrepresented facts relating to the likelihood of renewal of the company's most profitable exclusive license. The U.S. District Court for the Southern District of New York held that plaintiffs failed to adequately plead fraud and granted the defendants' motion to dismiss.

Plaintiffs claimed that certain executives made false statements in earnings calls, filings with the Securities and Exchange Commission and press releases regarding the likelihood of renewing an exclusive license to provide and run the networks and servers for the videogame "World of Warcraft" (WoW), which accounted for 90% of the company's revenues. Plaintiffs claimed that the company's executives engaged in a scheme to personally benefit from WoW before the expiration of the WoW license, which was ultimately not renewed, by, among other things, selling their shares of The9 during the class period. However, only one executive sold her shares, under a Rule 10b5-1 plan, and the company's president actually increased his beneficial holdings during the class period.

The court held that plaintiffs failed to sufficiently allege that defendants personally benefitted from the purported fraud. Because the inference that the company made a concerted effort to renew the license was stronger than the inference supporting scienter, the court rejected the plaintiffs' claims and granted the defendants' motion to dismiss. (*Glaser v. The9, Ltd.*, 2011 WL 1106713 (S.D.N.Y. March 28, 2011))

MetroPCS Escapes Securities Class Action

Shareholders of MetroPCS Communications, Inc., the nation's fifth-largest wireless communications provider, filed a federal securities class action against the company and certain of its officers, alleging that defendants made materially false or misleading statements or omissions regarding the company's future prospects that artificially inflated the value of MetroPCS common stock in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. The U.S. District Court for the Northern District of Texas held that plaintiffs failed to adequately plead fraud and granted the defendants' motion to dismiss.

The objectionable statements related to: (1) the accuracy of the 2009 earnings guidance issued at the end of 2008; (2) the strength of MetroPCS's business model in a recessionary economy; (3) the impact of increased competition on the wireless communications business; and (4) the relationship between subscriber growth and attrition, particularly in light of a cell phone promotion that may have attracted disloyal customers who were inclined to leave after the promotion ended. Plaintiffs alleged that certain officers sold their shares prior to announcing adjusted corporate financials for 2009, causing the stock price to fall from $18.85 to $6.01 per share.

The court determined that plaintiffs did not adequately allege a *strong* inference of scienter. The defendants' sale of shares pursuant to preexisting Rule 10b5-1 trading plans undermined any inference of suspiciousness surrounding the timing or amount of the stock sales. In addition, the claim that the defendants had access to information that the cell phone promotion was increasing the rate of customer attrition, and thereby was not accretive to the company, was not alleged with any particularity as to any individual defendant. The court dismissed the plaintiffs' Amended Complaint and ordered plaintiffs to reimburse MetroPCS's court costs. (*Hopson v. MetroPCS Communications, Inc., et al.*, Civil Action No. 3:09-cv-02392 (N.D. Tex. March 25, 2011))

BANKING

FDIC Board Approves Proposed Rule on "Living Wills" and Credit Exposure Reports for Large Organizations; Announces Remedies for Deficient Living Wills

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) approved on March 29 a joint Notice of Proposed Rulemaking (NPR) for covered systemic organizations to file and report resolution plans and credit exposure reports as required in Title I, Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Resolution plans, also known as "living wills," would have to be submitted within 180 days of the effective date of a final regulation, and Credit Exposure Reports would have to be filed 30 days after the end of each calendar quarter. The NPR is to be issued jointly with the Board of Governors of the Federal Reserve System. The regulation would apply to organizations that have $50 billion or more in total consolidated assets.

Under the Dodd-Frank Act, holding companies with assets of $50 billion or more and other covered non-bank systemically important financial companies supervised by the Federal Reserve (a covered company) must report periodically to detail their resolution plans and report significant credit exposures. The Dodd-Frank Act requires each company covered by the proposed rule to produce a resolution plan, or "living will," that includes information regarding the manner and extent to which any insured depository institution affiliated with the company is adequately protected from risks arising from the activities of any nonbank subsidiaries of the company; full descriptions of the ownership structure, assets, liabilities and contractual obligations of the company; identification of the cross-guarantees tied to different securities; identification of major counterparties; a process for determining to whom the collateral of the company is pledged; and any other information that the Federal Reserve and the FDIC jointly require by rule or order. The proposed rule would require a strategic analysis by the covered company of how it can be resolved under Title 11 of the U.S. Code (the Bankruptcy Code) in a way that would not pose systemic risk to the financial system.

Companies covered by the proposed regulations would also be required to identify and map their business lines to legal entities and provide integrated analyses of their corporate structure; credit and other exposures; funding, capital and cash flows; domestic and foreign jurisdictions in which they operate; their supporting information systems and other essential services; and other key components of their business operations. On a quarterly basis, covered companies would be required to submit a Credit Exposure Report to outline the nature and extent of credit exposures. Foreign-based companies would submit reports only on their U.S. operations. At a minimum, a covered company headquartered in the United States would be required to provide information on both its domestic and foreign operations. A foreign-based company would be required to provide information on its U.S.

operations and explain how resolution planning for its U.S. operations is integrated into the foreign-based company's overall interconnections and interdependencies.

After the initial resolution plan is submitted, each covered company would be required to submit a new resolution plan no later than 90 days after the end of each calendar year. A covered company would be required to file an updated resolution plan within a time period specified by the Federal Reserve and the FDIC, but no later than 45 days after any event, occurrence, change in conditions or circumstances or change which results in, or could reasonably be foreseen to have, a material effect on the resolution plan of the covered company. Ultimately, if the covered company fails to submit a revised resolution plan or the Federal Reserve and the FDIC jointly determine that a revised resolution plan submitted does not adequately remedy deficiencies identified by the Federal Reserve and the FDIC, then the Federal Reserve and FDIC may jointly subject a covered company or any subsidiary of a covered company to more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations. Any such requirements or restrictions shall apply to the covered company or subsidiary, respectively, until the Federal Reserve and the FDIC jointly determine the covered company has submitted a revised resolution plan that adequately remedies the deficiencies identified. In addition, if the covered company fails, within the two-year period beginning on the date on which the determination to impose such requirements or restrictions was made, to submit a revised resolution plan that adequately remedies the deficiencies jointly identified by the Federal Reserve and the FDIC, then the Federal Reserve and FDIC, in consultation with the Financial Stability Oversight Council, may jointly, by order, direct the covered company to divest such assets or operations as the Federal Reserve and FDIC jointly determine necessary to facilitate an orderly resolution of the covered company under the Bankruptcy Code in the event the company were to fail.

The proposed rule requires each covered company to submit to the Federal Reserve and the FDIC a Credit Exposure Report on a quarterly basis. Each Credit Exposure Report is required to set forth the nature and extent of credit exposures of such company to significant bank holding companies and significant nonbank financial companies as well as the credit exposures of significant bank holding companies and significant nonbank financial companies to such company.

The proposed rule will be out for comment 60 days after publication in the *Federal Register*.

Read more.

Agencies Seek Comment on Risk Retention "Skin in the Game" Proposal

Six federal agencies, the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development, are seeking comment on a proposed rule, approved by the FDIC on March 30, that would require sponsors of asset-backed securities (ABS) to retain at least 5% of the credit risk of the assets underlying the securities and would not permit sponsors to transfer or hedge that credit risk. The proposal, totaling 376 pages in length, would provide sponsors with various options for meeting the risk-retention requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The options include but are not necessarily limited to: (1) a "vertical" slice of the ABS interests, whereby the sponsor or other entity retains a specified *pro rata* piece of every class of interests issued in the transaction; (2) a "horizontal" first-loss position, whereby the sponsor or other entity retains a subordinate interest in the issuing entity that bears losses on the assets before any other classes of interests; (3) a "seller's interest" in securitizations structured using a master trust collateralized by revolving assets whereby the sponsor or other entity holds a separate interest that is *pari passu* with the investors' interest in the pool of receivables (unless and until the occurrence of an early amortization event); or (4) a representative sample, whereby the sponsor retains a representative sample of the assets to be securitized that exposes the sponsor to credit risk that is equivalent to that of the securitized assets. The proposed rules also include disclosure requirements that are an integral part of and specifically tailored to each of the permissible forms of risk retention.

As required by the Dodd-Frank Act, the proposal includes descriptions of loans that would not be subject to these requirements, including ABS that are collateralized exclusively by residential mortgages that qualify as "qualified residential mortgages" (QRMs). The proposal would establish a definition for QRMs—incorporating such criteria as borrower credit history, payment terms, and loan-to-value ratio—designed to ensure they are of very high credit quality. These underwriting standards include, among other things, maximum front-end and back-end debt-to-income ratios of 28% and 36%, respectively; a maximum loan-to-value (LTV) ratio of 80% in the case of a purchase transaction (with a lesser combined LTV permitted for refinance transactions); a 20% down payment requirement in the case of a purchase transaction; and credit history restrictions. The narrow definition of QRMs in

the proposal has been heavily criticized by various industry groups, but defended by the FDIC as consistent with the intent of the Dodd-Frank Act. The proposed rule also has a 0% risk-retention requirement for ABS collateralized exclusively by commercial loans, commercial mortgages, or automobile loans that meet certain underwriting standards. As with QRMs, these underwriting standards are designed to be robust and to ensure that the loans backing the ABS are of very low credit risk.

The proposed rule also includes investor disclosure requirements regarding material information concerning the sponsor's retained interests in a securitization transaction. The disclosures would provide investors and the agencies with a mechanism to monitor compliance with the risk-retention requirements of the proposed rules.

The proposed rule would also recognize that the 100% guarantee of principal and interest provided by Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (the Federal Home Mortgage Loan Corporation) meets their risk-retention requirements as sponsors of mortgage-backed securities for as long as Fannie Mae and Freddie Mac are in conservatorship or receivership with capital support from the U.S. government.

The agencies request comments on the proposed rule by June 10.

Read more.

UK DEVELOPMENTS

Ministry of Justice Publishes Bribery Act 2010 Guidance

On March 30, the UK Ministry of Justice published detailed guidance on "adequate procedures" for companies to put in place to prevent infringement of the Bribery Act 2010. It also published a shorter "quick start guide" aimed at smaller businesses.

The Bribery Act, which will come into force on July 1, creates four criminal offenses: (1) bribing another; (2) being bribed; (3) bribing a foreign official; and (4) (for commercial organizations) failing to prevent bribery. If a commercial organization can show that it has adequate procedures in place, this can form the basis of a defense to the offense of failing to prevent bribery.

The Ministry of Justice guidance sets out six principles that are intended to give commercial organizations a starting point for planning, implementing, monitoring and reviewing a bribery-free business regime. The six principles as set out in the guidance are:

1) Proportionate procedures
2) Top level commitment
3) Risk assessment
4) Due diligence
5) Communication
6) Monitoring and review

In connection with each of the principles, the guidance indicates procedures designed to assist organizations to address the relevant issues.

The guidance points towards a risk-based approach to adopting adequate procedures, proportionate to the risks faced by each organization. Different procedures will be appropriate depending on the size of the organization, the industry sectors and jurisdictions in which it does business, as well as the nature of its business partners and transactions.

Read more.

In addition, on March 30 the Director of Public Prosecutions and the Director of the Serious Fraud Office issued joint guidance for prosecutors setting out the Directors' approach to deciding whether to bring a prosecution under the Bribery Act.

Read more.

For more information, contact:

SEC/CORPORATE		
Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
David A. Pentlow	212.940.6412	david.pentlow@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
David S. Kravitz	212.940.6354	david.kravitz@kattenlaw.com
FINANCIAL SERVICES		
Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Guy C. Dempsey, Jr.	212.940.8593	guy.dempsey@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Maureen C. Guilfoile	312.902.5425	maureen.guilfoile@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Joseph Iskowitz	212.940.6351	joseph.iskowitz@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com
LITIGATION		
Julie Pechersky	212.940.6476	julie.pechersky@kattenlaw.com
Jessica M. Garrett	212.940.6523	jessica.garrett@kattenlaw.com
BANKING		
Jeffrey M. Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Christina Grigorian	202.625.3541	christina.grigorian@kattenlaw.com
UK DEVELOPMENTS		
Edward Black	44.20.7776.7624	edward.black@kattenlaw.co.uk

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London affiliate: Katten Muchin Rosenman UK LLP.