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CORPORATE & FINANCIAL
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## SEC/CORPORATE

### NASDAQ Proposes Tougher Listing Standards for Issuers Following Reverse Mergers

On April 18, the NASDAQ Stock Market LLC filed a proposed rule change with the Securities and Exchange Commission to adopt additional listing requirements for companies that have become public through transactions in which unlisted private operating companies merge into publicly traded shell companies, commonly known as reverse mergers. According to NASDAQ, proposed Rule 5110(c) was promulgated in response to widespread concerns of fraudulent behavior by, and unreliable financial statements of, reverse merger companies.

Proposed Rule 5110(c) would permit a company formed through such a reverse merger to submit an application for initial listing on a NASDAQ market only after that company has (1) traded for no less than six months in the over-the-counter market or on another national securities exchange or listed foreign market following the filing with the SEC or other regulatory authority of audited financial statements for the combined company, and (2) maintained a bid price of at least $4 per share on at least 30 of the 60 trading days immediately preceding the filing of the initial listing application.

The proposed rule also provides that a reverse merger company would only be approved for listing if, following the reverse merger transaction, it has timely filed (1) in the case of a domestic issuer, at least two periodic financial reports with the SEC or other regulatory authority, or (2) in the case of a foreign private issuer, one or more reports including financial statements for a period of not less than six months.

Proposed Rule 5110(c) would not apply to reverse merger companies applying for listing on NASDAQ in connection with a firm commitment underwritten public offering.

Read more.

### SEC Issues Study and Recommendation on SOX Section 404(b) for Issuers with Public Float Between $75 and $250 Million

Section 989G(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act required the Securities and Exchange Commission to conduct a study to determine how the SEC could reduce the burden of complying with Section 404(b) of the Sarbanes-Oxley Act (the auditor attestation requirement) for companies whose market capitalization is between $75 and $250 million, while at the same time maintaining investor protection. The SEC was also required to consider whether an exemption for such companies from Section 404(b) compliance would encourage the U.S. listing of initial public offerings (IPOs).

In a 113-page study published on April 22, the SEC concluded that the existing requirements for issuers with a $75-$250 million public float to comply with the auditor attestation provisions of Section 404(b) should be maintained and that no new exemptions should be granted. Specifically, the SEC found that over time the costs and burdens of Section 404(b) compliance have declined and that eliminating them would not "justify the loss of investor protections and benefits to issuers...". It also found that "the evidence does not suggest that granting an exemption to issuers that would expect to have $75-$250 million in public float following an IPO would, by itself, encourage companies in the United States or abroad to list their IPOs in the United States". In sum, the SEC, noting that the Dodd-Frank Act already exempts approximately 60% of reporting issuers from Section 404(b) compliance, does not recommend further extending this exemption.

Read more.

## BROKER DEALER

### OCC Proposes Rule Governing Retail Foreign Exchange Transactions

The Dodd-Frank Wall Street Reform and Consumer Protection Act amended the Commodity Exchange Act to provide that a U.S. financial institution for which there is a federal regulatory agency could not enter into retail foreign exchange (retail forex) transactions except pursuant to a rule or regulation of a federal regulatory agency allowing such transactions. The Office of the Comptroller of the Currency (OCC) has proposed a rule authorizing national banks, federal branches or agencies of foreign banks, and their operating subsidiaries (national banks) to engage in retail forex transactions. In addition, the proposed rule describes various requirements that national banks must comply with in order to engage in such transactions. The proposed rule is modeled on the Commodity Futures Trading Commission's retail forex rule in order to promote consistent treatment of retail forex transactions regardless of whether a retail forex customer's dealer is a national bank or a CFTC registrant. Comments on the OCC's proposed retail forex rule must be received by May 23.

Click here to read the OCC's proposal in the *Federal Register*.

### SEC Approves Consolidated Books and Records Rules

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's proposal to adopt consolidated rules governing books and records. The effective date for the new rules is December 5. The new rules, modeled after NASD Rule 3110, New York Stock Exchange Rule 440 and NYSE Rule Interpretations 410/01 and 410/02, will require member firms to make and preserve certain books and records to show their compliance with securities laws, rules and regulations. New FINRA Rule 4511, based on the general recordkeeping requirements of NASD Rule 3110(a) and NYSE Rule 440, clarifies that member firms must: (1) make and preserve books and records as required by FINRA rules, the Securities Exchange Act of 1934 (Exchange Act) and applicable Exchange Act rules; and (2) preserve books and records required by FINRA rules in a format and media that complies with Exchange Act Rule 17a-4. In addition, FINRA Rule 4511 requires member firms to preserve for at least six years those FINRA books and records for which there is no specified retention period under FINRA rules or applicable Exchange Act rules. The new books and records rules also address records of written customer complaints, authorization records for negotiable instruments, changes in account name or designation, predispute arbitration agreements, order audit trail system recordkeeping requirements, and pre-time stamping.

Click here to read FINRA Regulatory Notice 11-19.

## CFTC

### CFTC Publishes Fourteenth Series of Dodd-Frank Rules

The Commodity Futures Trading Commission has published its fourteenth series of proposed rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. These proposals include capital requirements for swap dealers (SDs) and major swap participants (MSPs), interpretive guidance regarding various proposed definitions and the regulation of mixed swaps, proposed rules concerning the bankruptcy protection of cleared swaps customer contracts and collateral, and amendments to adapt certain CFTC regulations to Dodd-Frank Act requirements.

- **Proposed Capital Requirements for Swap Dealers and Major Swap Participants:** The CFTC has proposed minimum capital requirements for those SDs and MSPs that are not subject to prudential regulation by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Farm Credit Administration or the Federal Housing Finance Agency (collectively, the Prudential Regulators), as well as SDs and MSPs that are registered as futures commission merchants (FCMs) with the CFTC. SDs and MSPs that are neither FCMs nor bank holding company subsidiaries and that do not have a Prudential Regulator would be required to maintain minimum tangible net equity of at least $20 million, plus additional amounts for market risk and over-the-counter derivatives credit risk. SDs and MSPs that are not FCMs, but that are nonbank subsidiaries of U.S. bank holding companies (and are not governed by a Prudential Regulator), would be required to meet the same capital requirements applicable to the bank holding company, subject to a minimum requirement of at least $20 million of Tier 1 capital. Finally, SDs and MSPs that are FCMs would be required to meet existing minimum net capital requirements applicable to FCMs, subject to a minimum adjusted net capital requirement of $20 million.

The CFTC proposal would permit SDs or MSPs to apply for CFTC approval to use internal models to calculate their capital requirements above the required minimum amounts. The proposal would initially require that such models be subject to ongoing review by the Federal Reserve Board (FRB) or the Securities and Exchange Commission, but would also permit the CFTC, by written order, to accept applications and approve models that are not subject to FRB or SEC review. The proposal also includes financial condition reporting and recordkeeping requirements for SDs and MSPs, similar to those currently applicable to FCMs.

- **Proposed Rules and Interpretive Guidance Concerning Certain Proposed Definitions:** The CFTC and SEC (together, the Commissions) have jointly proposed rules and interpretive guidance in connection with the proposed definitions of certain terms under the Dodd-Frank Act. In response to public comment on the CFTC's and SEC's previously proposed definitions of "swap" and "security-based swap," the Commissions issued proposed rules and interpretive guidance:

  (a) provide that certain insurance products, consumer and commercial agreements and loan participations are neither swaps nor security-based swaps;

  (b) clarify the scope of the forward contract exclusion from the swap definition for nonfinancial commodities;

  (c) make clear that the following products are within the scope of the definitions of swap and, where applicable, security-based swap: foreign exchange (FX) forwards and FX swaps (unless exempted by the Secretary of the Treasury), forward rate agreements and certain FX products that are outside the Treasury's determination (unless otherwise excluded by the Dodd-Frank Act) and options on swaps, forward swaps and certain contracts for differences; and

  (d) clarify when a Title VII instrument is a swap, a security-based swap or a mixed swap and propose rules in connection with the Commissions' joint regulation of mixed swaps.

  The Commissions' proposed rules and interpretive guidance also: (1) address several issues in the security-based swap definition with respect to the terms "narrow-based security index" and "issuers of securities in a narrow-based security index;" (2) provide direction about what types of products are considered security-based swap agreements (SBSAs); (3) clarify that the Commissions do not intend to propose additional books and records requirements with respect to SBSAs beyond those that the CFTC previously proposed for swaps; (4) set forth a process by which interested persons may request a joint interpretation by the Commissions on whether a particular Title VII instrument is a swap, a security-based swap or a mixed swap (similar to the statutory process for novel derivative products set forth in Section 718 of the Dodd-Frank Act); (5) would define as swaps those transactions that are deliberately structured so as to evade the provisions of Title VII governing the regulation of swaps; and (6) address the potential evasion of Title VII by persons located outside of the United States.

- **Protection of Cleared Swaps Customer Contracts and Collateral and Conforming Amendments to the Commodity Broker Bankruptcy Provisions:** In an advance notice of proposed rulemaking issued on November 19, 2010 (the November Proposal), the CFTC proposed four models for the protection of cleared swaps and associated collateral for FCM customers. Based on comments received in connection with the November Proposal, the CFTC has proposed the "Complete Legal Segregation Model" (referred to in the November Proposal as the "Legal Segregation with Commingling" model). (The current proposal regarding the Complete Legal Segregation Model is not to the exclusion of the three other models set forth in the November Proposal, which the CFTC is still evaluating.) Under the Complete Legal Segregation Model, an FCM would be permitted to commingle the cleared swap collateral of all cleared swap customers prior to bankruptcy. In the event of a default of both an FCM and one or more of the FCM's cleared swap customers, a derivatives clearing organization (DCO) would have recourse against the collateral of the defaulting customers, but not against the collateral of non-defaulting customers.

The proposed rules do not restrict the types of collateral that a customer would be able to post, but cleared swaps customers' margin deposits could be invested only in accordance with CFTC Regulation 1.25.

Finally, the CFTC also proposed amendments to modify certain of its Part 190 bankruptcy regulations to reflect Dodd-Frank Act requirements.

- **Proposed Amendments to Adapt Certain CFTC Regulations to the Dodd-Frank Act Requirements:** The CFTC has proposed to amend certain CFTC regulations to comport with the Dodd-Frank Act by:

  (1) requiring FCMs and introducing brokers (IBs) to comply with recordkeeping rules for swap transactions similar to the rules that currently apply with respect to futures transactions;

  (2) imposing recordkeeping requirements on members of swap execution facilities (SEFs) that are the same as those that currently apply to members of designated contract markets (DCMs);

  (3) requiring FCMs, IBs, retail FX dealers, and members of DCMs and SEFs to maintain records of all oral communications that lead to the execution of transactions in a commodity interest or cash commodity;

  (4) setting forth procedures for the end-of-day allocation of bunched orders for both cleared and uncleared products; and

  (5) amending certain existing definitions to apply to swaps in addition to futures.

  The CFTC has also proposed to amend certain other of its regulations in order to treat swaps similarly to futures and SEFs and swap data repositories analogously to DCMs.

Comments on the proposed rules are due within 60 days from the dates of their respective publication in the *Federal Register*.

Information regarding the fourteenth series of CFTC proposals, including the fact sheets and Q&As for each of the proposals, is available here.

## LITIGATION

### Suit Arising Out of SEC's Failure to Detect Madoff Ponzi Scheme Barred by Sovereign Immunity

The U.S. District Court for the Southern District of New York granted defendant United States' motion to dismiss a complaint brought by former investors in the investment advisory firm Bernard L. Madoff Investment Securities LLC (BMIS) seeking money damages under the Federal Tort Claims Act (FTCA) for losses suffered by plaintiffs in connection with the Ponzi scheme perpetrated by Mr. Madoff and BMIS.

The complaint, derived substantially from the Securities and Exchange Commission Office of Inspector General's 457-page report, entitled "Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme," alleged that the SEC was grossly negligent in carrying out its supervisory duties over the securities industry when it failed to uncover Mr. Madoff's Ponzi scheme despite numerous credible and detailed warnings between 1992 and 2008, and several investigations undertaken by the SEC into Mr. Madoff's and BMIS's trading activity.

In granting the United States' motion, the district court found that plaintiffs' claims were within the FTCA's discretionary function exception and barred by sovereign immunity. The court reasoned that the scope, manner and results of investigative activity undertaken by the SEC is "inherently discretionary and policy-driven," and the complaint failed to sufficiently allege any relevant statutory obligations that required the SEC to undertake a more thorough investigation into BMIS. (*Molchatsky v. United States*, 2011 WL 1471798 (S.D.N.Y. Apr. 19, 2011))

### Securities Fraud Claim Dismissed for Lack of Standing

The U.S. District Court for the District of Nevada dismissed a claim for securities fraud brought under Section 10(b) of the Securities Exchange Act on the ground that plaintiff lacked standing because he had never purchased or sold the securities in question.

Plaintiff was a doctor who worked at defendant Laboratory Medical Consultants (LMC) for 31 years and retired in 2006. LMC redeemed all of plaintiff's stock in accordance with the parties' 2001 Stockholders' Agreement at that time. Under the 2001 Stockholders' Agreement, a portion of plaintiff's deferred compensation benefits was to be secured by an escrow of plaintiff's stock. Plaintiff alleged that his shares were not properly placed in escrow and defendants conspired to defraud him of the value of his shares during the sale of LMC in 2007.

In granting defendant's motion to dismiss, the district court ruled that under Section 10(b), a claim for securities fraud must be made in connection with the purchase or sale of a security. Plaintiff did not allege that he was forced to sell his stock or even that it was sold. He alleged harm based on defendant's action in not placing the stock in escrow, or alternatively, based on defendant's placing the stock in escrow and then converting it. In dismissing the complaint, the court held that "the mere involvement of shares of stock does not bring a transaction within [Section 10(b)]." (*Slaughter v. Laboratory Medical Consultants,* 2011 WL 1486228 (D.Nev. Apr. 19, 2011))

## BANKING

### Federal Banking and Other Agencies Propose Incentive-Based Compensation Provisions

On April 14, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, the National Credit Union Administration, the Securities and Exchange Commission, and the Federal Housing Finance Agency, published a notice of proposed rulemaking in the *Federal Register* to implement the incentive-based compensation provisions of Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The joint proposed rule includes the following provisions that would apply to covered financial institutions with total consolidated assets of $1 billion or more:

- a prohibition on incentive-based compensation arrangements at covered financial institutions that encourage executive officers, employees, directors or principal shareholders (covered persons) to expose the institution to inappropriate risks by providing a covered person with excessive compensation;
- a prohibition on covered financial institutions from establishing or maintaining any incentive-based compensation arrangements, or any feature of any such arrangements, for covered persons that encourage inappropriate risks by the covered financial institution that could lead to material financial loss;
- a requirement that covered financial institutions develop and maintain policies and procedures appropriate to their size, complexity, scope and the nature of their use of incentive-based compensation to ensure and monitor compliance with the proposed rule's requirements and prohibitions; and
- a requirement that covered financial institutions submit annual reports that describe the structure of their incentive-based compensation arrangements.

The joint proposed rule also includes the following provisions applicable to covered financial institutions that have total consolidated assets of $50 billion or more:

- a deferral requirement for a portion of executive officers' incentive-based compensation. (At least 50% of the annual incentive-based compensation of the executive officers must be deferred over a period of no less than three years, with the release of deferred amounts to occur no faster than on a *pro rata* basis.); and
- a requirement that the board of directors, or a committee thereof, identify covered persons (other than executive officers) who have the ability to expose the covered financial institution to risk of losses that would be substantial in relation to its size, capital, or overall risk tolerance; approve the incentive-based compensation arrangement for the covered persons; and document such approval.

The comment period for the proposed rulemaking action closes on May 31.

Read more.

Please see "OCC Proposes Rule Governing Retail Foreign Exchange Transactions" in **Broker Dealer** above.

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