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BROKER DEALER

FINRA Reminds Firms of Upcoming Changes to BrokerCheck

The Financial Industry Regulatory Authority has issued an information notice reminding member firms of changes to BrokerCheck it will implement on August 23 and the steps firms and individuals may take with respect to these changes prior to implementation. As reported in the June 16 edition of *Corporate and Financial Weekly Digest*, these changes expand the information released through BrokerCheck and establish a formal process to dispute the accuracy of, or update, information disclosed through BrokerCheck.

Click here to read the FINRA information notice.

FINRA Will Defer to Exchange's Clearly Erroneous Determinations for Certain OTC Trades

The Financial Industry Regulatory Authority has issued an immediately effective rule change reinforcing its position that it will defer to an exchange's clearly erroneous determinations with respect to over-the-counter trades in exchange-listed securities when FINRA is deciding which similarly-situated transactions are subject to nullification by FINRA. FINRA states in the release that it believes this clarification is necessary to promote consistency among self-regulatory organizations. Comments are due to the Securities and Exchange Commission on or before August 27.

Click here to read Securities and Exchange Commission Release No. 34-62608.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Proposes Revisions for Mutual Fund Asset-Based Fees and Broker Sales Loads

On July 21, the Securities and Exchange Commission published a rulemaking proposal that would alter the way mutual funds impose 12b-1 fees and sales loads. The marketing and selling costs involved with running a mutual fund are commonly referred to as a mutual fund's distribution costs. To cover these costs, mutual funds are permitted to charge fees known as 12b-1 fees that are paid from the mutual fund's assets. These fees are deducted from a mutual fund to compensate securities professionals for sales efforts and services provided to the mutual fund's investors. The rule proposal would:

- *Limit "ongoing sales charges."* The proposal would limit the amount of asset-based sales charges that individual investors pay. In particular, the proposal would restrict these "ongoing sales charges" to the highest fee charged by the mutual fund for shares that have no ongoing sales charge. For example, if one class of the mutual fund charges a 4% front-end sales charge, another class could not charge more than 4% in total to investors over time. The mutual fund would keep track of how long investors have been paying ongoing sales charges. Separately, the mutual fund could continue to pay 0.25% per year out of its assets for distribution activities as "marketing and service" fees, for expenses such as advertising, sales compensation and services.

- *Enhance disclosure requirements*. The proposal would require mutual funds to identify and more clearly disclose distribution fees. In particular, a mutual fund would have to disclose any “ongoing sales charges” and any “marketing and service fees” in the mutual fund’s prospectus, shareholder reports and investor transaction confirmations. Transaction confirmations also would have to describe the total sales charge rate that an investor will have to pay.
- *Allow mutual funds to sell shares through broker-dealers who establish their own sales charges.* The proposal would enable mutual funds to sell shares through broker-dealers who determine their own sales compensation, subject to competition in the marketplace. As a result, broker-dealers could establish their own sales charges, tailor them to different levels of shareholder service, and charge shareholders directly, similar to how commissions are charged on securities such as common stock. The proposal would prevent mutual funds that rely on this exemption from deducting other sales charges from mutual fund assets for that class of shares.
- *Reduce mutual fund director duties*. The proposed amendments, which would set automatic limits on mutual fund fees and charges, would eliminate the need for mutual fund directors to explicitly approve and re-approve mutual fund distribution financing plans. Directors would still have responsibility for overseeing ongoing sales charges and marketing and service fees in the same manner that they oversee other mutual fund expenses, subject to their general fiduciary duties.

The deadline for public comment on the rule proposal is November 5.

The SEC’s proposing release can be found here.

LITIGATION

Tortious Interference Claim Fails Without Showing of Improper Means

Plaintiff, a distributor of motors and related products to automotive original equipment manufacturers and suppliers throughout the Midwest, brought claims against defendant, a manufacturer with whom plaintiff had a non-exclusive distribution agreement. Plaintiff claimed that defendant’s direct sale to plaintiff’s customers constituted, among other things, tortious interference with plaintiff’s business relationships.

The lower court granted defendant’s summary judgment motion, and the Sixth Circuit affirmed. The Sixth Circuit found that where, as here, defendant had a “legitimate interest, economic or otherwise, in the contract or expectancy sought to be protected, then the plaintiff must show that the defendant employed improper means in seeking to further only his own interests.” Because the distribution agreement did not preclude defendant from making direct sales to plaintiff’s customers, no liability for tortious interference could arise. (*Universal Electric Products Co., Inc. v. Emerson Electric Co.*, 2010 WL 2925930 (6th Cir. July 27, 2010))

Ninth Circuit Addresses “Reckless Scienter” Requirement

The U.S. Court of Appeals for the Ninth Circuit affirmed a district court’s partial grant of summary judgment in favor of plaintiff, the Securities and Exchange Commission, finding that defendants violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by issuing a fraudulent press release.

The SEC alleged that defendants’ press release, which stated that a new technology system was being “unveiled,” was false because at the time the press release was issued, the company had no prototypes for the system built, or even the money to build one. The district court granted summary judgment for the SEC on this claim.

On appeal, defendants contended that the statement was not issued with “reckless scienter” as required under Section 10(b). The Ninth Circuit held that scienter requires either “deliberate recklessness” or “conscious recklessness” that includes “a subjective inquiry” turning on “the defendant’s actual state of mind,” and that evidence showing that the defendants did not appreciate the gravity of the risk of misleading others is relevant. The court also found that a defendant ordinarily will not be able to defeat summary judgment by the mere denial of subjective knowledge of the risk that a statement could be misleading. Though summary judgment is generally inappropriate when mental state is an issue, a defendant with knowledge of the relevant facts cannot manufacture a genuine issue of material fact by denying what a reasonable person would have known.

Applying this standard, the court found that defendants knew that the company had not produced a complete, field-tested system, and the press release left the "unmistakable impression" that the new system existed. Because no reasonable juror could conclude that defendant was not conscious of the risk that the press release would be misinterpreted, the court held that there was no issue of material fact that the press release was materially misleading and issued with deliberate recklessness. (*Securities and Exchange Commission v. Platforms Wireless Int'l Corp.*, 2010 WL 2902393 (9th Cir. July 27, 2010))

EXECUTIVE COMPENSATION AND ERISA

DOL Adopts Amendment to Class Exemption for QPAMs

On July 6, the Employee Benefits Security Administration (EBSA) of the U.S. Department of Labor (DOL) adopted an amendment to Prohibited Transaction Exemption (PTE) 84-14 that permits qualified professional asset managers (QPAMs) to act as QPAMs for their own employee benefit plans, or the plans of an affiliate, if certain additional conditions are met. PTE 84-14 is a class exemption that allows parties related to employee benefit plans to engage in transactions otherwise prohibited by the Employee Retirement Income Security Act of 1974, as amended, if the assets are managed by a QPAM and if certain other conditions are met. PTE 84-14 requires a QPAM managing the assets of a plan it sponsors to adopt policies and procedures designed to ensure compliance with its conditions. The exemption also requires that an independent auditor conduct an annual exemption audit, which is designed to ensure that the conditions of the class exemption have been met. The amendment to PTE 84-14 affects plan participants, beneficiaries, sponsors and persons engaging in the transactions described above. The amendment was published in the July 6 edition of the *Federal Register* and is effective November 3.

For the DOL release, click here.

UK DEVELOPMENTS

FSA Fines Royal Bank of Scotland Group £5.6m for UK Sanctions Controls Failings

On August 13, the UK Financial Services Authority (FSA) announced that it had fined RBS Plc, NatWest, Ulster Bank and Coutts and Co (RBSG) £5.6 million (approximately $8.9 million) for failing to have in place adequate systems and controls to prevent breaches of UK financial sanctions. This is the biggest fine imposed by the FSA to date in pursuit of its financial crime objective. It is also the first fine imposed by the FSA under the Money Laundering Regulations 2007.

The Regulations require that firms maintain appropriate policies and procedures in order to prevent funds or financial services being made available to those on the HM Treasury Sanctions List. The FSA found that between December 15, 2007, and December 31, 2008, RBSG failed to adequately screen both their customers and the payments they made and received against the List.

The FSA considered that RBSG's failings in relation to their screening procedures were particularly serious because of the risk posed to the integrity of the UK financial services sector. Specifically, it could have facilitated transactions involving sanctions targets, including terrorist financing.

Margaret Cole, FSA Director of Enforcement and Financial Crime, said: "The scale of the fine shows how seriously the FSA takes this issue and should act as a warning to other firms to ensure that they have adequate screening procedures."

As RBSG agreed to settle at an early stage of the FSA investigation, it qualified for a 30% reduction in penalty which would otherwise have been £8 million (approximately $12.7 million).

Read more.

Supreme Court Confirms Court of Appeal Ruling on FSA Enforcement Capabilities

On July 28, the UK Supreme Court upheld the English Court of Appeal's judgment that the power of the UK Financial Services Authority (FSA) to prosecute criminal offenses was not limited to the offenses specified in sections 401 and 402 of the Financial Services and Markets Act 2000 (see the October 23, 2009, edition of *Corporate and Financial Weekly Digest*). In particular, the Supreme Court confirmed that the FSA has the power to prosecute money laundering and other offenses within the ambit of the FSA's statutory objectives.

To read the UK Supreme Court judgment, click here.

Court of Appeal Decides LBIE Client Money Application

On August 2, the English Court of Appeal handed down its judgment on the client money directions application made in the Administration of Lehman Brothers International (Europe) (LBIE). The Court of Appeal overturned Mr. Justice Briggs' High Court decision in part, holding unanimously that:

1. Clients whose money (as opposed to securities and other assets) should have been segregated by LBIE as client money prior to administration but was not are entitled to share in the client money pool.
2. Money held by LBIE (at the time of administration) outside its segregated client money accounts which is "identifiable client money" is to be pooled with the client money held in its segregated accounts.
3. The client money pool will be distributed *pro rata* to all of LBIE clients entitled to claim against the pool, with the share of each client calculated based on the amount of client money which should have been segregated, as a proportion of the total amount which LBIE should have segregated.

LBIE's Joint Administrators stated that they were considering the Court of Appeal's judgment carefully to assess its implications for LBIE's client money claimants and creditors, including, in particular, on the likely timing and level of any distribution of client money.

Read more.

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