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Please note that *Corporate and Financial Weekly Digest* will not be published on December 25, 2009, or January 1, 2010. The next issue will be distributed on January 8, 2010.

SEC/CORPORATE

SEC Issues Final Rules to Enhance Disclosure Regarding Corporate Governance and Clarify Proxy Rules

On December 16, the Securities and Exchange Commission adopted final rules intended to improve disclosure in the area of corporate governance and clarify the SEC's proxy rules.

The new rules, which are effective February 28, 2010, require issuers to disclose in their proxy statements (i) the impact of overall compensation policies and practices applicable to all employees on risk-taking that is reasonably likely to have a material adverse effect on the issuer; (ii) information concerning the qualifications, experience, skills and other attributes that qualify directors and nominees to serve on the board; (iii) whether, and if so, how, the nominating committee considers diversity when identifying nominees for director, (iv) the role of the board of directors in risk management; (v) the rationale for the issuer's corporate leadership structure; and (vi) fees paid to compensation consultants who advise both the board of directors and management under certain circumstances.

More specifically, the amended rules revise the disclosure of stock options and awards in the Summary Compensation Table and Director Compensation Table to require reporting of the aggregate grant date fair value of awards rather than current disclosure of the dollar amount of compensation recognized in that year for financial statement reporting purposes. In addition, issuers will be required to disclose whether and why they have chosen to combine or separate the chief executive officer and board chair positions.

The final rules also accelerate disclosure of election results by requiring issuers to disclose voting results in a current report on Form 8-K filed with the SEC within four days after the shareholder vote rather than in its Form 10-Q for that quarter.

A more detailed analysis of the Final Rules will be distributed in a Katten *Client Advisory* next week.

Click here for the press release issued by the Securities and Exchange Commission.
Click here for the Final Rule Release 33-9089.

SEC Re-Opens Public Comment Period for Shareholder Director Nomination Proposal

On December 14, the Securities and Exchange Commission announced in a rule-making notice that it is re-opening the public comment period for its shareholder director nomination proposal in an effort to solicit views on additional data and analyses received by the Commission at or after the end of the original public comment period, which was August 17. The Commission has received more than 500 comments on the proxy access rule. Comments are due no later than 30 days after the publication of the Commission's release in the Federal Register.

As previously reported in the May 22 and June 12 editions of *Corporate and Financial Weekly Digest* and a June 18 *Client Advisory*, the Commission proposed changes to the federal proxy rules to facilitate the exercise of shareholders' rights under state corporate law to nominate and elect directors. The SEC staff expects to make a final recommendation to the Commission in early 2010.

Click here for the SEC release.
Click here for the Proposed Rule Release No. 33-9086.

SEC Announces Effective Date for Filing Fee Increases

On December 17, the Securities and Exchange Commission announced the effective dates for previously disclosed adjustments to fee rates for registration of securities, securities repurchases in going private transactions, proxy solicitations and transactions on exchanges and certain over-the-counter markets. The SEC's announcement came in connection with the December 16 enactment of the congressional appropriations bill including funding for the SEC.

As reported in the May 8, October 2 and November 6 editions of *Corporate and Financial Weekly Digest*, registration fees under the Securities Act will increase from $55.80 per $1 million to $71.30 per $1 million. The increased rate is also applicable to the repurchase of securities in going private transactions pursuant to Section 13(e) of the Exchange Act, as well as to proxy solicitations and statements in corporate control transactions. The effective date for these changes is December 21.

Additionally, effective January 15, 2010, the fee rate applicable to securities transactions on the exchanges and in certain over-the-counter markets will decrease from $25.70 per $1 million to $12.70 per $1 million.

Click here for the SEC's press release regarding the effective dates for these fee adjustments.
Click here for the SEC's April 30 order announcing the adjustments to its fee rates.

LITIGATION

Investment in "Tenancy in Common" Interests Provided Basis for Securities Violations

The U.S. District Court for the District of Oregon granted summary judgment to the Securities and Exchange Commission in a securities fraud case involving a large-scale real estate securitization and management business.

Defendants, at their peak, operated over 280 senior housing facilities in 34 states with over $2 billion in asset value. The SEC alleged that defendants, offering investors interests in tenancies in common in these facilities, misled the investors by not disclosing that the negative and positive returns of individual facilities were shifted among the facilities in order to give, among other things, false impressions of profitability. Defendants also solicited new investors while materially failing to disclose to them that major credit defaults and foreclosures were imminent.

The court held that the tenancies in common constituted an investment in a common enterprise wherein investors depended on the defendants for returns and, therefore, were securities. The court went on to hold that defendants made material misstatements by failing to disclose the manner by which profits and losses were spread throughout the real estate portfolio and by failing to disclose rapidly deteriorating credit conditions. (*SEC v. Sunwest Management., Inc.*, No. 09 Civ. 6056, 2009 WL 4718775 (D. Or. Dec. 9, 2009))

Weak Internal Controls and GAAP Violations Supported Inference of Scienter in Securities Class Action

The U.S. District Court for the Southern District of New York denied defendants' motion to dismiss in a consolidated securities class action lawsuit, where defendant corporation had to restate its financials after making a series of disclosures regarding poor accounting controls.

Plaintiffs alleged that defendant corporation acknowledged its accounting problems through a series of press releases but that it nevertheless continued to file audited financials, certifying accordance with generally accepted accounting principles (GAAP). When the defendant corporation ultimately made a corrective disclosure, stating that its financials would have to be restated, its share price dropped immediately.

In the ensuing litigation, the defendant corporation argued that GAAP violations, standing alone, could not provide the basis for an inference of scienter. While the court agreed with this general principle, it ruled that GAAP violations combined with a pattern of disclosures about deficient controls demonstrated that the defendant knew it had accounting problems that were reflected in its certified financials. Further, the court relied upon an email from a member of defendant corporation's audit committee who had resigned, in which the departing director complained about the corporation's poor corporate governance and substandard accounting practices in finding that plaintiffs had adequately alleged that the defendant corporation knowingly misled investors about its internal controls. (*Varghese v. China Shenghuo Pharm. Holdings, Inc.*, No. 08 Civ. 7422, 2009 WL 4668579 (S.D.N.Y. Dec. 9 2009))

BROKER DEALER

CBOE Reminds Members of Annual Report Regarding Account Supervision

On December 15, the Chicago Board Options Exchange (CBOE) issued Regulatory Circular RG09-144 to remind members and members organizations that are approved to conduct business with non-members of the annual report to be filed with the CBOE by April 1 of each year. Under CBOE Rule 9.8(g), the filing must detail the member organization's supervision and compliance effort, including its options compliance program, during the preceding year and report on the adequacy of the member organization's ongoing compliance processes and procedures.

Click here to read CBOE Regulatory Circular RG09-144.

FINRA Proposes Fee Waiver for "As/Of" Trade Reports for Eight Days in August/September 2009

The Financial Industry Regulatory Authority is proposing to waive and issue a credit for fees charged to FINRA members for "as/of" trade reports submitted to the FINRA/Nasdaq Trade Reporting Facility and the OTC Reporting Facility for eight days in August and September 2009. Due to technology issues with the Automated Confirmation Transaction Service (ACT) during these days, members were unable to report trades on trade date and thus incurred higher-than-normal reporting charges because of the higher number of "as/of" reports they needed to submit. FINRA is proposing to waive and issue a credit for fees for "as/of" trade reports submitted on each day following the day on which these ACT technology issues occurred.

Click here to read Securities and Exchange Commission Release No. 34-61160.

PRIVATE INVESTMENT FUNDS

House Passes Private Fund Advisor Registration Act

On December 11, the U.S. House of Representatives voted 235-177 to approve sweeping financial regulatory reform, including the Private Fund Investment Advisers Registration Act (the Bill). The Bill was passed together with all of the amendments to the discussion draft reported out of the Financial Services Committee on October 27 (and covered in the October 30 edition of *Corporate and Financial Weekly Digest*). The legislation now moves to the Senate for consideration. Debate in the Senate may take place on a companion bill proposed in the Senate, rather than on this Bill.

To read the text of the Bill click here.
Click here for more information on the companion Senate legislation in the November 13 edition of *Corporate and Financial Weekly Digest*.

CFTC

CFTC Proposes New Rules Regarding Operation of Commodity Brokers in Bankruptcy

The Commodity Futures Trading Commission is proposing to amend its Bankruptcy Rules to permit the trustee for a bankrupt futures commission merchant to continue to operate the business of the commodity broker in the ordinary course for a limited period of time.

Currently, CFTC Rule 190.4 restricts the activities the trustee in bankruptcy may undertake on behalf of the commodity broker to (i) offsetting open commodity contracts, (ii) transferring delivery notices on open commodity contracts, and (iii) covering inventory or commodity contracts of the broker that cannot be immediately liquidated.

The proposed amendment is intended to address situations in which a commodity broker has filed for bankruptcy, possibly in consideration of an imminent sale of the commodity broker to a third party, but retains sufficient operating capital to enable the trustee to maintain ordinary course operations. In these circumstances, customers of the commodity broker would be permitted to continue managing their accounts during the period between the appointment of a trustee and the transfer of the customer positions from the bankrupt firm to another futures commission merchant.

The proposed amendment can be found here.

INVESTMENT COMPANIES AND INVESTMENT ADVISORS

SEC Approves Custody Rule Changes for Investment Advisors

The Securities and Exchange Commission has adopted amendments to Rule 206(4)-2, the custody rule under the Investment Advisers Act of 1940. When an advisor or its affiliate serves as custodian of client assets, the amended custody rule will now require the advisor to (i) engage an independent public accountant to conduct an annual surprise exam to verify that client assets exist (the accountants would be required to contact the SEC within one day if they discovered client assets were missing) and (ii) obtain a written report—prepared by an accountant that is registered with and subject to regular inspection by the Public Company Accounting Oversight Board (PCAOB)—that, among other things, describes the controls in place at the custodian, tests the operating effectiveness of those controls and provides the results of those tests (a SAS-70 report). An advisor maintaining client assets with an independent custodian generally would not be subject to the foregoing requirements, but would be required to undergo a surprise exam if it has the ability to write checks on or otherwise disburse client assets for any reason other than to collect the advisor's fees. Advisors to hedge funds and other private funds that comply with the custody rule by obtaining an audit of the fund and delivering the fund's financial statements to fund investors will also not be subject to the foregoing requirements, provided that the auditor of the fund is registered with, and subject to regular inspection by, the PCAOB. The full text of the final rule amendment has not yet been published; we expect to be able to provide more information after it is released. The rule amendment will become effective 60 days after publication in the Federal Register.

Click here to read the SEC press release on the approved final rule amendments.
Click here to read the summary of the amendments as proposed in the May 22 edition of *Corporate and Financial Weekly Digest*.

BANKING

FDIC Finalizes Risk-Based Capital Rule Related to FAS 166/167

On December 16, the Board of Directors of the Federal Deposit Insurance Corporation finalized the regulatory capital rule related to the Financial Accounting Standards Board's adoption of Statements of Financial Accounting Standards Nos. 166 and 167. Beginning in 2010, these new accounting standards will make substantive changes to how banks account for securitized assets that are currently excluded from their balance sheets.

Banks affected by the new accounting standards generally will be subject to higher minimum regulatory capital requirements. The final rule provides an optional delay and phase-in for a maximum of one year for the effect on risk-based capital and the allowance for lease and loan losses related to the assets that must be consolidated as a result of the accounting change. The final rule also eliminates the risk-based capital exemption for asset-backed commercial paper assets. The transitional relief does not apply to the leverage ratio or to assets in conduits to which a bank provides implicit support.

The rule provides temporary relief from risk-based measures. Banks will be required to rebuild capital and repair balance sheets to accommodate the new accounting standards by the middle of 2011.

Publication in the *Federal Register* is expected shortly.

Read more.

STRUCTURED FINANCE AND SECURITIZATION

Please see "FDIC Finalizes Risk-Based Capital Rule Related to FAS 166/167" in **Banking** above.

UK DEVELOPMENTS

FSA Publishes Policy Statement on Stress and Scenario Testing

On December 11, the UK Financial Services Authority (FSA) published a policy statement entitled "Stress and Scenario Testing." It outlines the FSA's policy on stress testing and includes a new "reverse stress testing" requirement.

The strengthened integrated stress testing regime is made up of three main elements:

- Firms' own stress testing—The FSA expects firms to develop, implement and action a robust and effective stress testing program (including reverse stress testing) that assesses their ability to meet capital and liquidity requirements in stressed conditions.
- FSA stress testing of specific firms—As part of its more intrusive supervisory procedures, the FSA runs its own stress tests on a periodic basis for a number of firms, to assess their ability to meet minimum capital levels throughout a stress period. It does this regularly for specific high-impact firms, and for other firms when it is considered necessary.
- Simultaneous system-wide stress testing—This is carried out by firms using a common scenario for the purposes of specific system-wide analysis for financial stability purposes.

The FSA has set out its view of good practices in stress and scenario testing in an annex to the statement. Firms subject to the new reverse stress testing requirement will have 12 months to implement the new requirements. In the first quarter of 2010, the FSA plans to issue an implementation timetable for firms to submit to the FSA to explain how they plan to incorporate reverse stress testing into their current risk management.

Click here to read the policy statement in full.

UK Government Sets Out Plans to Manage Investment Bank Failures

On December 16, the UK Government published a report entitled "Establishing resolution arrangements for investment banks," in which it set out proposals to strengthen the UK's ability to deal with any future failure of an investment bank. The report builds on ideas outlined by the UK Government in a May 2009 discussion paper (as reported in the May 15 edition of *Corporate and Financial Weekly Digest*).

The UK Financial Services Secretary, Paul Myners, said: "The collapse of Lehman Brothers last October had a major impact on financial centers across the world. It is important that the government acts to ensure that any future failure of an investment bank does not cause the same degree of damage to markets or investors."

The core of the proposals is a set of measures designed to enable the managed wind-down of an investment bank. This includes the development of a new administration (insolvency) regime for a failed investment bank. Specific initiatives set out in the report expressed to be designed to achieve better outcomes for key groups affected by the failure of an investment bank include measures to speed up the return of client money and assets, address counterparty exposures to the firm, and ensure creditors are sufficiently protected.

The report recognizes the need for proposals such as these to be taken forward in an international context.

The UK Government aims to continue a period of consultation before publishing a final report in the second quarter of 2010 setting out firm proposals and a timetable for action.

Click here to read the report in full.

FSA and UK Treasury Publish Joint Paper on Reforming OTC Derivative Markets

On December 16, the UK Financial Services Authority and the UK Treasury published a joint paper entitled "Reforming OTC Derivative Markets" in which they set out the steps required to address the deficiencies with the over-the-counter (OTC) derivative markets highlighted by the financial crisis.

In summary, the paper sets out the following measures to be implemented and/or developed to address perceived systematic shortcomings in OTC derivative markets:

- Greater standardization of OTC derivatives contracts—This would enhance efficiency of operational processes and facilitate the use of central counterparty (CCP) clearing.
- More robust counterparty risk management—This would mean using CCP clearing for clearing eligible products and using proper arrangements and appropriate risk capital requirements for trades which are not centrally cleared.
- Consistent and high global standards for CCPs—Increased use of CCPs will heighten their systemic importance, so it is crucial that they are regulated to high standards which are consistently applied in major jurisdictions.
- International agreement as to which products are "clearing eligible"—Both regulators and CCPs will need to be involved in assessing which products are eligible for clearing.

- Capital charges to reflect appropriately the risks posed to the financial system—Non-centrally cleared trades should have proportionately higher charges.
- Registration of all relevant OTC derivative trades in a trade repository—This will facilitate regulators having access to the information they need to fulfill their regulatory responsibilities.
- Greater transparency of OTC trades to the market—This will aid price formation and market efficiency.
- On-exchange trading—With all of the above steps implemented, there will not be a need for mandating the trading of standardized derivatives on organized trading platforms.

Click here to read the paper in full.

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