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Corporate and Financial Weekly Digest

Business/Financial News in Brief
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A Note from the Editor

The *Corporate and Financial Weekly Digest* will not be published next Friday, December 29. The next issue will be distributed on January 5, 2007. Our wishes for happy holidays and a healthy and prosperous New Year.

Bob Kohl

SEC/Corporate

SEC Further Extends Section 404 Compliance Deadline for Smaller Companies

On December 15, the Securities and Exchange Commission adopted a final rule further extending the dates by which non-accelerated filers must comply with the internal control reporting requirements of Section 404 of the Sarbanes-Oxley Act of 2002. The deadline by which a non-accelerated filer must include management's assessment of internal control over financial reporting has now been extended to annual reports for fiscal years ending on or after December 15, 2007 (from July 15, 2007). For the first year of compliance, management's assessment will be deemed "furnished" rather than filed. The SEC indicated that it might further postpone that deadline if it has not issued guidance to management on how to complete such assessment in time for issuers to make use of such guidance in preparing annual reports for those periods. The deadline by which a non-accelerated filer must comply with the auditor attestation requirement has been extended to annual reports for fiscal years ending on or after December 15, 2008 (also from July 15, 2007). The SEC indicated that it would consider extending this date after it considers revisions to Auditing Standard No. 2.

In addition, the SEC provided for a transition period for newly public companies with respect to compliance with Section 404. Under the new rule, a newly public company will not have to comply with Section 404 until it either had to file an annual report with the SEC for the prior fiscal year or had filed an annual report with the SEC for the prior fiscal year.
http://www.sec.gov/rules/final/2006/33-8760.pdf

PCAOB Proposes Revised Auditing Standard on Internal Controls over Financial Reporting

On December 19, the Public Company Accounting Oversight Board proposed a new standard on auditing internal control over financial reporting. The proposed new standard encourages auditors to use their judgment in deciding which internal controls should be reviewed, focusing on areas where fraud or error is

most likely, in an attempt to eliminate unnecessary requirements and reduce unnecessary costs while increasing the chances of preventing significant misstatements. The standard does not, however, differentiate among companies based on size, despite calls from a number of commentators, including the SEC Advisory Committee on Smaller Public Companies, to exempt smaller public companies from Section 404 internal control requirements.
http://www.securitiesmosaic.com/gateway/pcaob/docket/021/2006-12-19_Release_No._2006-007.pdf
http://www.nytimes.com/2006/12/20/business/20audit.html

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Broker Dealer

Proposed Amendments to Regulation SHO and Rule 10a-1

The Securities and Exchange Commission proposed amendments to Regulation SHO and Securities Exchange Act Rule 10a-1. Regulation SHO and Rule 10a-1 prohibit short sales of securities traded on a stock exchange at prices less than the preceding trades.

The SEC has proposed removing the tick test of Rule 10a-1 and adding Rule 201 to Regulation SHO, which would provide that no price test, including any price test of any self-regulatory organization (SRO), would apply to short sales in any security. The SEC also would amend Rule 200(g) of Regulation SHO to remove the requirement that a broker-dealer mark a sell order of an equity security as “short exempt” if the seller is relying on an exemption from the price test of Rule 10a-1, or any price test of any SRO.

The SEC noted that today’s markets are characterized by high levels of transparency and regulatory surveillance, characteristics that greatly reduce the risk of abusive or manipulative short selling. The SEC also noted that the general anti-fraud and anti-manipulation provisions of the federal securities laws would continue to prohibit activity that improperly influences the price of a security.

Comments are due by February 12, 2007.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/E6-21156.htm

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Banking

Fed and SEC Propose Rules to Implement Broker Exceptions for Banks under the Gramm-Leach-Bliley Act of 1999

Seven years after passage of the Gramm-Leach-Bliley Act of 1999 (GLB Act), the Securities and Exchange Commission and Board of Governors of the Federal Reserve System on Monday announced the release of joint proposed rules to implement the “broker” exceptions for banks under Section 3(a)(4) of the Securities Exchange Act of 1934. The SEC and the Board approved issuing the joint proposed rules for public comment at separate open meetings held on December 13 and December 18, respectively.

The proposed rules would help define the scope of securities activities that banks may conduct without registering with the SEC as a securities broker and would implement the most important "broker" exceptions for banks adopted by the GLB Act. Specifically, the proposed rules would implement the statutory exceptions that allow a bank, subject to certain conditions, to continue to conduct securities transactions for its customers as part of the bank's trust and fiduciary, custodial and deposit "sweep" functions, and to refer customers to a securities broker-dealer pursuant to a networking arrangement with the broker-dealer.

Comments on the proposed rules are requested within 90 days of publication in the Federal Register, which is expected soon. The agencies request comment on all aspects of the proposed rules.
http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20061218/attachment.pdf

Elimination of Annual Report on Indebtedness of Executive Officers and Principal Shareholders to Correspondent Banks

Section 601 of the Financial Services Regulatory Relief Act of 2006 (Relief Act) removed several statutory reporting requirements relating to insider lending by insured banks and savings associations (institutions). One of these amendments eliminated the statutory requirement that an executive officer or principal shareholder of an institution file an annual report with the institution's board of directors during any year in which the officer or shareholder, or a related interest of the officer or shareholder, has an outstanding extension of credit from any of the institution's correspondent banks.

Accordingly, the FFIEC 004 report is being discontinued and, to the extent appropriate, the federal banking agencies are amending their regulations to eliminate the statutory reporting requirement. These regulations are found in 12 CFR Part 215 for member banks, 12 CFR Part 349 for insured state nonmember banks, 12 CFR Part 31 for national banks, and 12 CFR 563.43 for savings associations.

Institutions and their insiders should note that Section 601 of the Relief Act does not alter the substantive restrictions on loans made to executive officers and principal shareholders of banks and savings associations by their correspondent banks set forth in 12 U.S.C. 1972(2).
http://www.fdic.gov/news/news/financial/2006/fil06108.pdf

SAR Revised to Support Joint Filing and Reduce Duplicate SARs

The Financial Crimes Enforcement Network (FinCEN) and the federal banking agencies announced on December 21 that the format for the Suspicious Activity Report by Depository Institutions (SAR-DI) has been revised to reduce the number of duplicate SARs filed for a single suspicious transaction. The revisions are the result of a joint effort by FinCEN and the federal banking agencies.

The revised SAR-DI format was released on December 21 to allow depository institutions to begin planning for the implementation date of June 30, 2007. On this date, depository institutions will have the option of using either the existing or the revised SAR-DI formats. Use of the revised format for filing will become mandatory December 31, 2007. The ability to file using E-Filing, or electronic filing, is currently being finalized, as are the Magnetic Media Specifications. The new form should not be filed until the actual effective implementation date of June 30, 2007.

Financial institutions can review and download the PC fill-in version (using Adobe Reader or Acrobat) from the FinCEN website at www.fincen.gov under "What's New." The accompanying form instructions contain "How to" information for completing the form.

Any questions regarding the revised format may be directed to the FinCEN BSA Forms Manager via the FinCEN Helpline at 1-800-949-2732 (option 6) or to the appropriate federal banking agency.
http://www.fincen.gov/press_release_12212006.pdf

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United Kingdom Developments

HM Treasury and FSA Publish Simplification Plans for Better Regulation

On December 11 and 12, the HM Treasury and the Financial Services Authority (FSA) published consultation plans for the simplification of UK financial services regulation. The two plans are intended to be read together.

The Treasury simplification plan sets out a number of proposals designed to deregulate, consolidate and rationalize existing financial services regulations enforced by HM Treasury and the Office of Government Commerce (OGC). The overall objective is to reduce the administrative costs of complying with HM Treasury and OGC regulations by 25%.

The simplification plan contains 22 measures, of which the most significant are: reform of the financial promotion regime; simplification of the Regulated Activities Order; reducing reporting requirements for "controllers" (significant shareholders) of regulated entities; and the introduction of a Regulatory Reform Order designed to improve FSA efficiency. Further initiatives relate to improving anti-money laundering, counter-terrorist financing and asset-freezing requirements.

The period for comments to be submitted to HM Treasury extends to Autumn 2007.

In conjunction with HM Treasury's consultation, the FSA published its simplification plan. The FSA outlined progress made to date in areas such as: the reform of conduct of business rules (including financial promotions); improvements to complaints handling and dispute resolution; changes to the approved persons regime; and consolidation work to simplify the FSA Handbook. The FSA plans to continue work on implementing improvements to the joint regulation of firms supervised by both the FSA and the Office of Fair Trading as well as improvements to information sharing and joint enforcement with other regulators. Additional future work includes a review of the enforcement and decision making manuals, and regulations permitting marketing authorized funds of hedge funds to retail investors.
http://www.hm-treasury.gov.uk./media/713/86/better_regulation_simplificationplan.pdf
http://www.fsa.gov.uk/pubs/other/simplify_plan.pdf

Implementation of Companies Act 2006

On December 18, the government made a Written Statement to the House of Commons providing details about the commencement dates of provisions of the Companies Act 2006.

The provisions in the Act relating to changes to the First Company Law Directive (e-communication with Registrar of Companies) will be implemented with effect from January 1, 2007.

The following provisions linked to implementation of the EU Transparency Obligations Directive will be effective January 20, 2007: (i) the provisions on company e-communications with shareholders and others; (ii) provisions concerning a public company's right to investigate who has an interest in its shares; (iii) provisions setting out the statutory basis of directors' liability to the company in relation to the directors' report and remuneration report; and (iv) all powers to make orders or regulations by statutory instrument.

On April 6, 2007 the provisions implementing the Takeovers Directive will commence, and the provisions in Part X of the Companies Act 1985 relating to the disclosure of share dealings by directors and their families will be repealed, as will the age limit on directors.

The government will consult in February 2007 on detailed implementation plans for the remaining provisions and the whole of the Act will be implemented by October 2008.
http://www.publications.parliament.uk/pa/cm200607/cmhansrd/cm061218/wmstext/61218m0004.htm#06121817000508

FSA Reviews Inside Information Controls

On December 15, the Financial Services Authority (FSA) announced that it had started a thematic review of controls over the handling of inside information on public company takeovers and other mergers and acquisitions. This will be carried out in consultation with the Panel on Takeovers and Mergers.

The work of the review team (which hopes to publish its findings in spring 2007) will involve looking at a small number of deals where a leak of information took place. The review team will hold discussions with key parties to takeovers, some of which are regulated but many of which are not. Those to be contacted will include advisers, lawyers, PR firms, printers, issuers, debt and equity providers. The FSA will aim to consult on ways to tighten the flow of information, and will, among other matters, review the adequacy of information barriers and stop lists.
http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter18.pdf

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Litigation

Circuit Court Finds Exclusive Distributorship Agreement Does Not Illegally Harm Competition

In denying appellant's appeal from the district court's dismissal of, among others, its antitrust claim brought under Section 1 of the Sherman Act, the Second Circuit, held that an exclusive distributorship agreement between an already monopolistic lumber supplier and its exclusive distributor did not cause an unreasonable restraint on competition. Appellant, a former distributor of the supplier's product, argued that the exclusive distributorship agreement between the supplier and the new distributor illegally restrained competition because consumers would have fewer choices and would be forced to pay higher prices. The Court rejected this argument, nothing that exclusive distributorship agreements are presumptively legal and that the appellant had not pleaded facts showing that the exclusive agreement caused any harm to competition. To the contrary, the Court reasoned that the supplier already had control over the distribution of its product by virtue of its monopoly in the relevant market and that such control was not increased by the exclusive distributorship agreement. The Court noted that the complaint did not assert that the supplier's market share in any way constituted an illegal monopoly. (*E&L Consulting v. Doman Industries*, 2006 WL 3692437, (2d Cir. Dec. 15, 2006))

Pension Fund Alleging Largest Total Loss, Not Percentage Loss, Appointed Lead Plaintiff

The United States District Court for the District of Massachusetts appointed a pension fund as the lead plaintiff in a class action securities claim, rejecting competing applications from two other plaintiffs, including an individual investor who alleged a greater total loss and another pension fund that alleged a larger percentage loss. The Court explained that the Private Securities Litigation Reform Act typically requires that the lead plaintiff in a class action claim demonstrate, among other things, that it has the "largest financial interest" in the litigation. Although the individual investor allegedly suffered the largest total losses, the Court rejected his selection as lead plaintiff. The Court first noted that the PSLRA favors the selection of large institutional investors as lead plaintiffs. It then determined that because the individual investor did not acquire his shares on the open market, but rather as part of a merger transaction, he was vulnerable to unique defenses that would not be applicable against the two institutional investors. The unsuccessful pension fund applicant argued that it should be appointed because it had a greater percentage loss than the other pension fund (*i.e*, even though its gross losses were not as large as the pension fund selected, because it was a smaller fund, the percentage impact was greater). The Court held that the pension fund which lost the greater absolute dollar amount was the plaintiff with the "largest financial interest" in the outcome of the litigation and noted that the "percentage loss" test would favor smaller pension funds. (*Leech v. Brooks Automation, Inc.*, 2006 WL 3690736 (D. Mass. Dec. 13, 2006))

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CFTC

NFA BASIC System to Report CTA and CPO Exemption Information

The National Futures Association (NFA) has enhanced its Background Affiliation Status Information Center (BASIC) system to include additional information about certain exemptions claimed by commodity trading advisors (CTAs) and commodity pool operators (CPOs) under Commodity Futures Trading Commission rules. Specifically, the BASIC system now allows users to verify whether a CTA or CPO has filed an exemption from registration or reporting requirements pursuant to CFTC Rule 4.7, 4.13 or 4.14. This information is accessible on BASIC from the "Details" screen for the relevant CTA or CPO.
http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=1717

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