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# Corporate and Financial Weekly Digest

Business/Financial News in Brief
**December 8, 2006**

## SEC/Corporate

### SEC Sets Ambitious Agenda for its December 13 Meeting

On December 6, the Securities and Exchange Commission announced the subject matter of its next open meeting. At the December 13 meeting, the SEC will consider whether to:

1) jointly propose, together with the Board of Governors of the Federal Reserve System, new rules under the Securities Exchange Act of 1934, as amended, to implement exceptions under the Graham-Leach-Bliley Act to the definition of "broker" for banks, as well as rules exempting banks from the definition of "dealer";

2) repropose a new rule that would enable a foreign private issuer meeting specified conditions to terminate its Exchange Act registration and reporting obligations under Section 12(g) or 15(d) of the Exchange Act;

3) repropose a rule amendment that would apply the exemption from Exchange Act registration under Rule 12g3-2(b) immediately upon termination of registration and reporting obligations under the new exit rule described above;

4) propose interpretive guidance to assist management of reporting companies in planning and performing the annual evaluation of internal control over financial reporting as required pursuant to the Sarbanes-Oxley Act, and propose amendments to Rule 13a-15 and Rule 15d-15 under the Exchange Act providing that a company that performs an evaluation in accordance with such guidance would satisfy the annual evaluation required by those rules;

5) adopt amendments to the proxy rules under Section 14 of the Exchange Act that would permit satisfaction of the Rule 14a-3 requirement to furnish proxy materials by posting those proxy materials on a website and providing shareholders of notice of the availability of those materials, and consider mandating Internet disclosure of proxy materials;

6) propose a new antifraud rule under the Investment Advisers Act of 1940, as amended (this item was originally announced for the SEC's December 4 meeting but was postponed);

7) propose a new rule under the Securities Act of 1933, as amended, to revise the criteria for natural persons to be considered "accredited investors" for purposes of investing in certain privately offered investment vehicles (this item was originally announced for the SEC's December 4 meeting but was also postponed); and

8) re-open the comment period on proposed Rule 0-1(a)(7) under the Investment Company Act to enhance the independence and effectiveness of investment company directors, and publish economic analyses of mutual fund governance and independence issues by the Office of Economic Analysis.

Absent from the agenda are two eagerly awaited items previously thought to have been up for consideration at the December 13 open meeting: the revised and reproposed executive compensation rule regarding highly compensated employees (the so-called "Katie Couric rule"), and clarification of the "relates to election" exclusion of shareholder proposals under Rule 14a-8(i)(8) in the wake of the Second Circuit decision in *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.*
http://www.sec.gov/news/digest/2006/dig120606.txt

**For more information, contact:**
Robert L. Kohl at (212) 940-6380 or e-mail robert.kohl@kattenlaw.com, or
Mark A. Conley at (310) 788-4690 or e-mail mark.conley@kattenlaw.com, or
David A. Pentlow at (212) 940-6412 or e-mail david.pentlow@kattenlaw.com

## Banking

### FDIC Solicits Comments on Improvements to Determining Insured Deposits at Large Banks

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC) is soliciting comments on proposed improvements to the process of determining the insurance status of depositors of larger institutions in the event of a failure. While no large banks are currently thought to be in danger of failing, the FDIC wants to ensure, should a failure occur, that its processes for determining which accounts have FDIC insurance are efficient in order to prevent delays. For purposes of the advance notice of proposed rulemaking (ANPR), a large institution would have more than 250,000 deposit accounts and $2 billion in domestic deposits or at least $20 billion in total assets and $2 billion in domestic deposits, regardless of the number of deposit accounts. Currently, 159 institutions out of the more than 8,700 insured by the FDIC meet the criteria.

The FDIC reviewed and considered the 28 comments received from the first ANPR. Based on its deliberations, the FDIC is soliciting comments on the following proposed new approach which divides large institutions into two tiers:

- Tier 1 would include the most complex of the large institutions. They would be required to:
  - Identify the owner(s) of each account by using a unique depositor identifier.
  - Provide the FDIC a standard data framework; the format and content of the data structure for this framework will be developed in cooperation with insured institutions.
  - Provide the FDIC a standardized data structure to compute a trial balance or supply the institution's actual closing trial balance.
  - Calculate and place provisional holds automatically in the event of failure.
  - Remove provisional holds to be replaced by the FDIC-supplied holds/debits as reflected by the deposit insurance determination results.
- Tier 2 would include the remainder of large institutions. Requirements for this tier would be similar to Tier 1, except a unique depositor identifier would not be required.

The ANPR also requests comment on whether large institutions should be encouraged or required to know the insurance status for each new account opened and/or notify the customer of this status. Further

comment is requested on whether a unique depositor identifier and insurance category should be required for new accounts.

The last time the FDIC updated its deposit insurance determination process was in 1999. The largest number of deposit accounts in a failed institution where the FDIC had to make an insurance determination was on July 27, 2001, for Superior Bank, FSB, Hinsdale, Illinois, with about 90,000 deposit accounts. Today, some of the larger banks have more than 50 million deposit accounts.
http://www.fdic.gov/news/board/5dec06n6reg.pdf

**FDIC Board Proposes Basel 1-A Capital Standard for Most Banks; Extends Comment Period on Basel II for the Largest Banks**

The Board of Directors of the Federal Deposit Insurance Corporation (FDIC), on December 6, approved an interagency proposed rule that would provide a new option for how most banks and thrifts in the U.S. calculate their minimum risk-based capital requirements. The capital framework is commonly referred to as Basel 1-A, and would be available to all banks except the largest and most complex. (Those banks will be covered by the international capital accord known as Basel II, which was issued for comment by U.S. regulators in September.)

Within the Basel 1-A proposal, the agencies are seeking comment on alternatives to the Advanced Approaches for determining risk-based capital requirements for those banks that are proposed to be subject to the Basel II requirements. The agencies seek comments on whether to allow Basel II banks to adopt the standardized approach that foreign regulators permit, or the Basel 1-A standard once it is adopted.

Banks not subject to the Basel II standards will have the option to adopt Basel 1-A requirements or remain subject to the existing risk-based capital rules. Under the proposal, capital standards for institutions that adopt the new requirements would:

- Add three new risk weights to the existing framework, 35%, 75% and 150%;
- Expand the use of external credit ratings for certain exposures;
- Expand the range of eligible collateral and guarantors used to mitigate credit risk;
- Use loan-to-value ratios to determine risk weights for most residential mortgages;
- Increase the credit conversion factors for certain commitments with an original maturity of less than one year;
- Assess a risk-based capital charge to reflect the risks in securitizations with early amortization provisions that are backed by revolving exposures; and
- Remove the 50 percent limit on the risk weight that applies to certain derivative contracts.

Comments will be accepted for 90 days from the date of publication in the *Federal Register* once all of the banking agencies have approved the interagency Notice of Proposed Rulemaking (NPR).

The Board also approved an extension of the comment period for Basel II to coincide with the Basel 1-A comment period.
http://www.fdic.gov/news/board/5dec06n3reg.pdf
http://www.fdic.gov/news/board/5dec06n4reg.pdf

**For more information, contact:**
Jeff Werthan at (202) 625-3569 or e-mail jeff.werthan@kattenlaw.com, or

Christina J. Grigorian at (202) 625-3541 or e-mail christina.grigorian@kattenlaw.com, or
Adam Bolter at (202) 625-3665 or e-mail adam.bolter@kattenlaw.com

## Broker Dealer

**SEC Expands Finder Exemption**

In a no-action letter to Country Business, Inc. (CBI) the Securities and Exchange Commission expanded the scope of activities in which a finder could engage without having to register as a broker-dealer under the Securities Exchange Act of 1934.

CBI proposed to act as a business broker for closely-held companies that were small business companies as defined in the regulations of the Small Business Administration. CBI's role would be limited to: (i) transmitting documents between the parties; (ii) valuing the assets of the business as a going concern; (iii) providing the seller with administrative support; and (iv) assisting the seller with the preparation of financial statements.

The SEC staff conditioned the no-action relief as follows: (i) if a decision is made to effect the transaction by a sale of securities, CBI will have a limited role in negotiations between the seller and potential purchasers or their representatives and will not have the power to bind either party in the transaction; (ii) the business represented by CBI is a going concern and not a "shell" organization; (iii) the selling company satisfies the size standards for a "small business" pursuant to the Small Business Size Regulations issued by the U.S. Small Business Administration; (iv) only assets will be advertised or otherwise offered for sale by CBI; (v) if the transaction is effected by means of securities, it will be a conveyance of all of the business's equity securities to a single purchaser or group of purchasers formed without the assistance of CBI; (vi) CBI will not advise the two parties whether to issue securities, or otherwise to effect the transfer of the business by means of securities, or assess the value of any securities sold (other than by valuing the assets of the business as a going concern); (vii) CBI's compensation will be determined prior to the decision on how to effect the sale of the business, will be a fixed fee, hourly fee, a commission, or a combination thereof, that is based upon the consideration received by the seller, regardless of the means used to effect the transaction and will not vary according to the form of conveyance; (viii) CBI's compensation will be received in the amounts and at the times of the seller's receipt of proceeds; and (ix) CBI will not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.
http://www.sec.gov/divisions/marketreg/mr-noaction/cbi110806.htm

**NASD Reaffirms Limits on Gifts**

As a result of a recent review of gift and gratuity practices at member firms, the National Association of Securities Dealers, Inc. released Notice to Members 06-69 reminding member firms of the guidelines for gifts and gratuities permitted under NASD Rule 3060. Rule 3060 prohibits any member firm or person associated with a member firm from giving, or permitting to be given, anything of value in excess of $100 per individual per year where such payment is in relation to the business of the recipient's employer.

The NASD noted that the $100 limit generally does not apply to personal gifts such as a wedding gift or a congratulatory gift for the birth of a child, provided that these gifts are not "in relation to the business of the employer of the recipient." Reimbursement by the member firm of the person giving the gift will result in a presumption that the gift is in relation to the firm's business. Additionally, the restriction generally does not apply to gifts of de minimis value, such as pens, notepads, or modest desk ornaments, or to promotional items of nominal value that display the firm's logo. However, the NASD advised

member firms that to ensure compliance with this $100 limit, member firms must aggregate all gifts given by the member firm and each associated person of the member firm to a particular recipient over the course of a year. Moreover, the NASD reminded member firms that each member firm must state in its procedures whether it is aggregating all gifts given by the firm and its associated persons on a calendar year, fiscal year, or on a rolling basis beginning with the first gift to any particular recipient.
http://www.nasd.com/RulesRegulation/NoticestoMembers/2006NoticestoMembers/NASDW_018023

**SEC Reschedules Considering Hedge Fund Rules**

In a December 1 News Digest, the Securities and Exchange Commission announced that rule proposals (i) to prohibit advisers to pooled investment vehicles from making false or misleading statements to investors in those vehicles and (ii) to increase the criteria for natural persons to be "accredited investors" for investing in privately offered pooled investment vehicles would not be considered at the December 4 meeting, as previously announced. In the December 6 News Digest the SEC announced that these proposals would be considered at its December 13 meeting. See the "SEC/Corporate" section above.
http://www.sec.gov/news/digest/2006/dig120606.txt
http://www.sec.gov/news/digest/2006/dig120106.txt

**NASD Allows On-Demand Webcasts to Satisfy Annual Compliance Meeting**

NASD Rule 3010(a)(7) requires a firm to conduct an annual compliance meeting for all of its registered persons. Citigroup Global Markets, Inc. (CGMI) requested that it be permitted to satisfy this requirement by means of a webcast on its intranet that would be available on demand. Registered persons would log in with a unique identifier and password. The system would track each user and the number of minutes the webcast stays open. The webcast would be a click-as-you-go configuration; at the end of the webcast a pop up box would open for the viewer to attest they viewed the entire webcast. Viewers would be able to e-mail or call a central number with questions. The questions and answers would be posted to the firm's intranet. Records of attendance would be kept in a read only format for tracking and reporting to management. CGMI would update the content and record a new broadcast. The NASD staff advised that this proposed, on demand webcast was consistent with Rule 3010(a)(7) as interpreted by Notice to Members 99-45.
http://www.nasd.com/RulesRegulation/PublicationsGuidance/InterpretiveLetters/ConductRules/NASDW_018026

**For more information, contact:**
James D. Van De Graaff at (312) 902-5227 or e-mail james.vandegraaff@kattenlaw.com, or
Daren R. Domina at (212) 940-6517 or e-mail daren.domina@kattenlaw.com, or
Patricia L. Levy at (312) 902 5322 or e-mail patricia.levy@kattenlaw.com, or
Morris N. Simkin at (212) 940-8654 or e-mail morris.simkin@kattenlaw.com

## United Kingdom Developments

**JMLSG Issues Further Guidance on Money Laundering Reporting Officers' Annual Reports**

On December 4, the U.K. Joint Money Laundering Steering Group (JMLSG) published a suggested framework for the annual report to senior management required to be prepared by a Money Laundering Reporting Officer (MLRO). The Financial Services Authority has previously issued guidance stating that an MLRO should present an annual report to senior management, but without specifying format or contents. JMLSG's guidance sets out a fairly detailed suggested framework under four general headings: (i) responsibilities for anti-money laundering systems and controls; (ii) the operation of those systems and controls; (iii) summary of relevant business issues; and (iv) conclusions and recommendations for action

by senior management. The general aim of the MLRO's annual report should be to reach conclusions on the effectiveness of the firm's systems and controls, and should make appropriate recommendations for improvement in the management of risks and priorities, including resources. The level of detail required will depend on the type and size of the relevant firm and JMLSG emphasizes the need to apply its guidance flexibly in the context of each individual firm.
http://www.bba.org.uk//bba/jsp/polopoly.jsp?d=362&a=7984

**Companies Act 2006 Finally Published**

In the November 10 CFWD, we reported that the Companies Act 2006 had completed its passage through Parliament on November 8, but that the final text of the Act was not yet available. The Office of Public Sector Information (OPSI) announced on December 7 the text of the Act, the longest statute ever passed by the U.K. Parliament, has now been published on OPSI's website.
http://www.opsi.gov.uk/acts/acts2006/ukpga_20060046_en.pdf

**For further information contact:**
Martin Cornish at +44 20 7776 7622 or e-mail martin.cornish@kattenlaw.co.uk, or
Edward Black at +44 20 7776 7624 or e-mail edward.black@kattenlaw.co.uk

## Litigation

**Second Circuit Clarifies Heightened Standard Plaintiffs Must Meet to Gain Class Certification and Rejects Order Certifying Class in Massive IPO Securities Litigation**

In 2001, thousands of investors filed class actions against 55 underwriters, 310 issuers, and hundreds of individual officers, each alleging a scheme to defraud the investing public in connection with 310 initial public offerings (IPOs). These actions were consolidated for pretrial purposes in the Southern District of New York before Judge Shira A. Scheindlin. The Consolidated Class Action Complaint alleged various violations of the Securities Act of 1933 and the Securities Exchange Act of 1934 which the Plaintiffs supported with, among others, allegations that the underwriter defendants: (i) conditioned allocations of shares at the offer price on the recipient's agreement also to purchase shares in the aftermarket; (ii) required customers to pay the underwriters excessive commissions on transactions in other securities in exchange for allocations of shares in "hot" IPOs; and (iii) failed to disclose conflicts of interest relating to analyst reports prepared in connection with the challenged IPOs. Six of the 310 consolidated class actions were chosen as "focus cases" for class certification. On October 13, 2004, the District Court granted in part the Plaintiffs' motion for class certification in the six focus cases, ruling that Plaintiffs had satisfied their burden of making "some showing" that they had met Rule 23's requirements for certification. Under Rule 23(f), the Second Circuit granted defendants immediate appeal of this ruling.

In its decision vacating the District Court's certification order, the Second Circuit first acknowledged that it had been "less than clear as to the applicable standards for class certification" and that its precedents had "understandably led Judge Scheindlin astray." Thereafter, following an analysis of the case law in the Second Circuit and in other circuits, the Second Circuit expressly disavowed prior rulings in which it had approved a less rigorous burden for a plaintiff seeking class certification to meet and set forth new rules governing the requisite showing. These rules, which bring the Second Circuit in line with, among others, the Third, Fourth and Seventh Circuits, include: (i) a district judge may not certify a class without making a determination that each Rule 23 requirement has been met, (ii) such determination can be met only if the judge resolves factual disputes relevant to each Rule 23 requirement and finds that the requirement has been met, and (iii) the court's obligation to determine whether a Rule 23 requirement has been met is not lessened even if that determination overlaps with an issue going to the merits of the putative class's claims. The Second Circuit noted that its ruling did create a risk that Rule 23 hearings might extend into

protracted mini-trials of substantial "merits" issues, but found that the risk could be avoided by according district court judges "considerable discretion" to limit both discovery and the scope of a Rule 23 hearing.

Rather than remand the case to the District Court for reconsideration under the standards set forth in its decision, the Second Circuit found it appropriate to apply them on its own. The Court returned the case to the District Court after ruling that "the Plaintiffs' own allegations and evidence demonstrate that the Rule 23 requirements of predominance of common questions over individual questions cannot be met under the standards as we have explicated them" and that "the cases pending on this appeal may not be certified as class actions." (*In re Initial Public Offering Securities Litigation*, 2006 WL 3499937 (2d Cir. Dec. 5, 2006))

**For more information, contact:**
Alan Friedman at (212) 940-8516 or e-mail alan.friedman@kattenlaw.com, or
Julia Chung at (212) 940-6394 or e-mail julia.chung@kattenlaw.com

## CFTC

### CFTC to Publish New "Commitments of Traders" Report

The Commodity Futures Trading Commission will publish, beginning on January 5, 2007, a new, additional "Commitments of Traders" (COT) report that will show the aggregate futures and options positions of Noncommercial, Commercial and "Index Traders" in 12 agricultural commodities. This new Index Traders category will separate the positions reported by certain commodity index traders from the existing COT reports' Commercial and Noncommercial categories, in order to more accurately present the COT data for those categories—that is, to show the positions of traders engaged in hedging cash market activities (Commercial) and traders who are speculating (Noncommercial). Included as Index Traders are managed funds and other institutional investors who seek passive exposure to commodity prices as an asset class using standardized commodity indices, as well as entities whose trading primarily reflects hedging of over-the-counter transactions involving commodity indices, such as certain swap dealers. The new COT report will be published as part of a two-year pilot program.
http://www.cftc.gov/opa/press06/opa5262-06.htm
http://www.cftc.gov/files/cftc/cftcnoticeonsupplementalcotreport.pdf

**For more information, contact:**
Kenneth Rosenzweig at (312) 902-5381 or e-mail kenneth.rosenzweig@kattenlaw.com, or
William Natbony at (212) 940-8930 or e-mail william.natbony@kattenlaw.com, or
Fred M. Santo at (212) 940-8720 or e-mail fred.santo@kattenlaw.com, or
Kevin Foley at (312) 902-5372 or e-mail kevin.foley@kattenlaw.com, or
David Benson at (312) 902-5642 or e-mail david.benson@kattenlaw.com, or
Chris Hennion at (312) 902-5521 or e-mail christian.hennion@kattenlaw.com, or
Alex Liker at (312) 902 -5281 or e-mail alex.liker@kattenlaw.com

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**Katten**

**Katten Muchin Rosenman LLP**

www.kattenlaw.com

401 S. Tryon Street
Suite 2600
Charlotte, NC 28202-1935
704.444.2000 tel
704.444.2050 fax

525 W. Monroe Street
Chicago, IL 60661-3693
312.902.5200 tel
312.902.1061 fax

5215 N. O'Connor Boulevard
Suite 200
Irving, TX 75039-3732
972.868.9058 tel
972.868.9068 fax

1-3 Frederick's Place
Old Jewry
London EC2R 8AE
+44.20.7776.7620 tel
+44.20.7776.7621 fax

2029 Century Park East
Suite 2600
Los Angeles, CA 90067-3012
310.788.4400 tel
310.788.4471 fax

575 Madison Avenue
New York, NY 10022-2585
212.940.8800 tel
212.940.8776 fax

260 Sheridan Avenue
Suite 450
Palo Alto, CA 94306-2047
650.330.3652 tel
650.321.4746 fax

1025 Thomas Jefferson Street, NW
East Lobby, Suite 700
Washington, DC 20007-5201
202.625.3500 tel
202.298.7570 fax

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