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Corporate and Financial Weekly Digest

February 13, 2009

SEC/Corporate

New SEC Chairman Outlines Enforcement Changes and Other Agenda Items

In a February 6 address to Practicing Law Institute's "SEC Speaks in 2009", Mary L. Shapiro, the new Chairman of the Securities and Exchange Commission, outlined a number of enforcement changes she has initiated and provided a preview of some planned regulatory initiatives.

Acknowledging criticism of the SEC enforcement function, Shapiro indicated that she is immediately taking action to end the SEC's two-year "penalty pilot" program which had required the Enforcement Staff to obtain Commission authorization before negotiating a settlement involving civil monetary penalties for public companies in securities fraud cases. She stated that this pre-approval process had resulted in significant delays in settlements and sometimes resulted in reductions in the size of the penalties imposed. Empowering the Enforcement Staff to negotiate penalties without requiring prior approval from the Commission itself will, she stated, expedite the SEC's enforcement efforts. Another immediate change to the SEC's enforcement protocols is to streamline the process by which the Enforcement Staff obtains subpoenas to compel witness testimony and the production of documents. Currently, formal orders of investigation (without which subpoenas cannot be issued) are subject to full review of all five Commissioners, requiring advance notice with resulting delays. Shapiro indicated that she had given direction for the SEC to return to an earlier policy of timely approval of formal orders of investigation by seriatim Commission approval or, where appropriate, by a single Commissioner acting as duty officer. Additional enforcement measures, she stated, include improving the handling of tips and whistleblower complaints and focusing on areas where investors are most at risk.

As to regulatory and governance matters, Shapiro outlined an agenda which included improving the quality of credit ratings (the SEC recently released final rules and re-proposed rules with respect to credit rating agencies, as described in the February 6, 2009, edition of *Corporate and Financial Weekly Digest*); supporting a centralized clearing house for credit default swaps; improving the quality of audits for non-public broker-dealers; promoting the safe and sound custody of customer assets by any broker-dealer or investment adviser; and forming an Investor Advisory Committee "to ensure that the Commission hears first hand about the issues most concerning to investors".

http://www.sec.gov/news/speech/2009/spch020609mls.htm

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First Circuit Sets Standard for Whistleblower Provision of Sarbanes-Oxley

The First Circuit recently upheld a grant of summary judgment by the U.S. District Court for the District of Massachusetts. The plaintiff had brought a claim against his employer for a violation of the Sarbanes-Oxley Act's whistleblower protection provision 18 U.S.C. 1514A. The plaintiff alleged that he was fired for complaining of conduct that he believed consisted of both securities fraud and shareholder fraud. The employer countered that the actions the plaintiff complained about did not constitute fraud or securities law violations and that the plaintiff was fired for poor work performance and an inability to cooperate with his coworkers. In a case of first impression in the First Circuit, the Court of Appeals held that in order to successfully claim a violation of the whistleblower protection provision, the employee bears the initial burden to establish that he had a "reasonable belief" that the action of which he complained was a violation of the pertinent laws listed in the Act. Agreeing with the test set forth in the Fourth Circuit, the court held that the "reasonable belief" had to be both subjectively reasonable as well as objectively reasonable. When the court applied this test to the instant case, it found that the plaintiff brought his complaints in subjective good faith. However, the court held that there was no objectively reasonable basis to believe that the conduct of which he complained constituted securities fraud or shareholder fraud, as alleged by the plaintiff. Without an objectively reasonable belief that the conduct constituted either securities fraud or shareholder fraud, the court determined that the whistleblower protection provision did not shield the plaintiff from termination. Therefore, the court affirmed the District Court's grant of summary judgment in favor of the defendants. (*Day v. Staples, Inc.*, 2009 WL 294804 (1st Cir. February 9, 2009))

Investment Advisers Act Has a One/Three-Year Statute of Limitations

The U.S. District Court for the Eastern District of Texas adopted the magistrate judge's findings and recommended disposition and granted summary judgment in favor of the defendants. The plaintiff had brought claims against the defendants for violations of the Investment Advisers Act of 1940 (IAA). Specifically, the plaintiff claimed that the defendant violated Section 206 of the IAA, which makes it unlawful for any investment adviser "to employ any device, scheme, or artifice to defraud any client or prospective client." The court first noted the limited private remedies available under the Act. It then sought to determine the applicable limitations period for claims under the IAA by examining a decision by the Second Circuit finding that the limitations period provided for by the Securities Acts is the most appropriate limitations period for a claim under the IAA. The Second Circuit had determined that the proper limitations period should be one year from the wrong or the discovery of the wrong but not more than three years from the wrong. The court in the case at hand found that the plaintiff's claim was filed more than six years after the wrongs had occurred and, as a result, was time-barred. The plaintiff argued that her claim was an equitable claim because she sought disgorgement of profits and therefore it should not be subject to a statute of limitations. The court found that the cases the plaintiff cited for this proposition were clearly distinguishable to the case at bar, and noted that other district courts had followed the limitations period determined by the Second Circuit for claims brought under the IAA. Therefore, because the plaintiff's claims were not filed within three years of the date of the wrong, regardless of when discovered, they were time-barred. Summary judgment was granted in favor of the defendants. (*Dommert v. Raymond James Financial Services, Inc.*, 2009 WL 275440 (E.D. Tex. February 3, 2009))

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Broker Dealer

CBOE Extends Temporary Rule Allowing for Cabinet Trades Below $1 per Contract

On January 29, the Chicago Board Options Exchange, Inc. (CBOE) extended a temporary rule amendment that provides for "cabinet" trades, referring to trades in listed options that are worthless or not actively traded, to take place in open outcry at prices of at least $0 but less than $1 per option contract. Absent the amendment, the minimum price of a cabinet trade would be $1 per option contract. The CBOE believes that allowing the lower price range facilitates the closing of options, particularly given recent market conditions which have resulted in many series being out-of-the-money. The rule amendment was operative upon filing with the Securities and Exchange Commission and is in effect until May 29, 2009.

http://www.sec.gov/rules/sro/cboe/2009/34-59331.pdf

SEC Approves New CBSX Order Type

On February 4, the Securities and Exchange Commission approved a rule proposed by the CBOE Stock Exchange (CBSX) to adopt a Trade, Flash and Cancel order type. Such orders will be executed against the quotation published on the CBSX automatically if the CBSX is quoting at the national best bid or offer (NBBO) when the order is submitted. However, if the CBSX is not quoting at the NBBO, then a Trade, Flash and Cancel order will be electronically exposed to CBSX traders for up to three seconds, rather than being routed to other markets, to provide CBSX traders the opportunity to trade with the order by matching or improving the NBBO. Use of the Trade, Flash and Cancel order type is voluntary.

http://www.sec.gov/rules/sro/cboe/2009/34-59359.pdf

Changes to FINRA Rules Regarding Supervision of Market Letters

The Financial Industry Regulatory Authority issued a Regulatory Notice to announce Securities and Exchange Commission approval for National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) rule changes that will allow member firms to supervise "market letters" as correspondence rather than sales literature unless the letters are distributed to 25 or more existing retail customers within any 30-calendar day period and make a financial or investment recommendation or otherwise promote the firm's products or services. The term "market letter" means any communication specifically excepted from the definition of "research report" under NASD Rule 2711(a)(9)(A) and Incorporated NYSE Rule 472.10(2)(a), respectively. The rule changes will eliminate current requirements that mandate approval prior to use for qualifying market letters that meet the new definitions. The changes became effective February 5.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p117804.pdf

NYSE And NYSE Arca Submit Market Data Rule Filings

The New York Stock Exchange, LLC (NYSE) and NYSE Arca, Inc. (NYSE Arca) made rule filings to implement programs that would allow data vendors to redistribute exchange last sale information on a real-time basis. The NYSE filing introduces the NYSE Trades service on a pilot basis. This NYSE-only market data service would allow vendors to distribute data that NYSE reports to the Consolidated Tape Association (CTA) on a real-time basis at no charge during the pilot period. At the same time, NYSE made a filing that would

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establish a fee schedule for the receipt and redistribution of the data feed that would not commence until the later of SEC approval of the fee filing and the end of the pilot period program. The NYSE Arca filing contemplates a similar service for NYSE Arca last sale information. Currently, there are latency differences between accessing last sale data through the exchange and the CTA feeds that can be measured in milliseconds. The exchanges anticipate that demand for the products will derive from users who use the exchange feeds to power trading algorithms or smart order routers.

http://www.sec.gov/rules/sro/nysearca/2009/34-59308.pdf
http://www.sec.gov/rules/sro/nyse/2009/34-59290.pdf

ISE Gives Priority to Certain Non-Broker-Dealer Orders

The International Securities Exchange, LLC (ISE) filed a proposed rule change to (i) give certain non-broker-dealer orders, identified as "professional orders," the priority given broker-dealer orders and market maker quotes rather than the priority currently given all public customer orders, and (ii) charge the same transaction fees for professional orders as charged for the orders of broker-dealers and market makers. The Securities and Exchange Commission has approved the proposed rule, as modified by Amendments Nos. 1 and 2.

The ISE proposed to create two new order types: Priority Customer Orders and Professional Orders. Priority Customer Orders would be orders for the account of a Priority Customer, which would be defined as a person or entity that is not a broker-dealer in securities and that does not place more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Professional Orders would be defined as orders for the account of a person or entity that is not a Priority Customer, and would include proprietary orders of ISE members and non-member broker-dealers. Priority Customer Orders would have priority over Professional Orders at the same price. Thus, Public Customers who now have priority over broker-dealers and market makers at the same price would be on parity with market markers and broker-dealers at the same price, if those Public Customers placed more than 390 orders in listed options per day on average during a calendar month. These Professional Orders also would be assessed the same fees that ISE charges for broker-dealer transactions.

http://www.sec.gov/rules/sro/ise/2009/34-59287.pdf

Structured Finance and Securitization

Treasury Introduces Housing Support and Foreclosure Support Measures in Financial Stability Plan

On February 10, the U.S. Treasury Department introduced the Financial Stability Plan, part of which focuses on stemming foreclosures and restructuring troubled mortgages to help alleviate the housing crisis. The Treasury announced that it will soon introduce a comprehensive plan that builds on the work of congressional leaders and the Federal Deposit Insurance Corporation, elements of which will include:

- attempting to drive down overall mortgage rates, partly by spending as much as $600 billion on purchases of government-sponsored enterprise mortgage-backed securities and debt;
- committing $50 billion to prevent avoidable foreclosures by helping to reduce monthly mortgage payments;
- establishing loan modification guidelines and standards for government and private programs;
- requiring all Financial Stability Plan recipients to participate in foreclosure mitigation plans consistent with Treasury guidance; and

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- building flexibility into the Hope for Homeowners program and the Federal Housing Administration to enable loan modifications for a greater number of distressed borrowers.

http://www.kattenlaw.com/files/upload/Financial%20Stability%20Plan_Fact%20Sheet.pdf

Please see **"Treasury's Financial Stability Plan May Create Investment Opportunities for Funds"** in **Private Investment Funds**.

Please see **"TARP Inspector General Issues Inquiry Letters"** in **Banking**.

CFTC

CFTC Staff Issues Recordkeeping Advisory

The staff of the Division of Market Oversight of the Commodity Futures Trading Commission has issued an advisory regarding recordkeeping requirements applicable to futures commission merchants, introducing brokers and exchange members. In the advisory, the staff states that the recordkeeping requirements of CFTC Regulations 1.31 and 1.35 extend to all electronic communications relating to exchange and underlying cash commodity transactions, including emails, instant messages and other forms of communication that are created or transmitted electronically. In determining whether a particular communication is subject to these recordkeeping requirements, the staff emphasized that the content of the communication, rather than the medium, is determinative.

http://www.cftc.gov/newsroom/generalpressreleases/2009/pr5611-09.html
http://www.cftc.gov/stellent/groups/public/@industryoversight/documents/file/recordkeepingdmoadvisory0209.pdf

Private Investment Funds

Treasury's Financial Stability Plan May Create Investment Opportunities for Funds

On February 10, Treasury Secretary Timothy Geithner announced a comprehensive Financial Stability Plan to address the continuing credit crisis. Two aspects of the plan are expected to create new opportunities for private investment funds to take advantage of public financing to make private investments: one in respect of "legacy" troubled assets on the balance sheets of financial institutions and one in respect of newly issued, AAA-rated asset-backed securities (ABS).

Legacy Assets

First, the plan calls for the creation of a new $500 billion to $1 trillion Public-Private Investment Fund in which the Federal Deposit Insurance Corporation, Federal Reserve and Treasury Department will cooperate to pair public and private capital, including capital from private investment funds, to make large-scale purchases of "legacy" assets currently clogging the balance sheets of financial institutions. Originally, the Troubled Asset Relief Program (TARP) was to have involved the purchase by the government of large amounts of troubled residential and commercial mortgage loans and related securities and other assets from financial institutions, but private investment funds were specifically excluded from the list of entities who could take advantage of the program. In contrast, although few details are available, the Public-Private Investment Fund appears to be specifically targeted to provide financing to encourage purchases of such assets from financial institutions by private investment funds. Further, the announced intention of the plan is to allow the private

CFTC

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buyers to determine the appropriate pricing for such purchases, even though substantial amounts of public moneys will be employed in the deals. Since details are not yet available, it is not clear what restrictions, disclosure requirements or other terms will apply.

New Issuances

Second, private investment funds should be able to access the significantly expanded version of the Term Asset-Backed Securities Loan Facility (TALF) program under the new "Consumer & Business Lending Initiative" to purchase newly issued AAA-rated eligible ABS. The new plan would expand the current TALF from $200 billion to up to $1 trillion and add commercial mortgage loans to the list of assets that may underlie eligible ABS. The other asset types are auto, student and Small Business Administration loans and credit card receivables with additional asset types under consideration by the Treasury and the Federal Reserve. Any private investment fund that is organized in the United States and managed by an investment manager that has its principal place of business in the United States is an eligible TALF borrower, excluding private investment funds and investment managers controlled by foreign governments. Private investment funds with U.S.-based managers organized outside of the United States may participate in the program through newly formed or existing subsidiaries organized in the United States so long as such subsidiaries are managed by the U.S.-based manager and otherwise meet the preceding requirements.

http://www.kattenlaw.com/files/upload/Financial%20Stability%20Plan_Fact%20Sheet.pdf
http://www.kattenlaw.com/federal-reserve-and-treasury-provide-talf-pricing-haircuts-and-other-further-revised-terms-02-12-2009/

Banking

TARP Inspector General Issues Inquiry Letters

Beginning late last week, recipients of Troubled Asset Relief Program (TARP) Capital Purchase Program (CPP) funds received a letter from the TARP Inspector General appointed under the Emergency Economic Stabilization Act inquiring about the financial institution's:

- Use of TARP funds
  - Anticipated uses at time CPP application was submitted
  - Any segregation of TARP funds
  - Actual uses
  - Expected uses of unspent funds
  - Any actions which would not have been taken without the CPP funds
- Status of compliance with executive compensation limitations
  - Any assessment of loan risks and their relationship to executive compensation
  - Details of implementation of limitations
  - Whether changes to longer-term or deferred compensation have offset the effect of the TARP compensation limitations

Responses signed by a senior executive officer and supporting documentation are required within 30 days of the date of the letter and are subject to criminal penalties for false statements.

All documents referencing the actual or anticipated use of TARP funds, including internal emails, budgets and memoranda are requested to be segregated and preserved.

BANKING

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The form of the letter is not publicly available; however, for more information about the Office of the Special Inspector General for the Troubled Asset Relief Program, please see the following link: http://sigtarp.gov/index.shtml

Financial Markets

Representative Peterson Introduces the Derivatives Markets Transparency and Accountability Act of 2009

The House Agriculture Committee has approved an amended version of Chairman Collin Peterson's Derivatives Markets Transparency and Accountability Act of 2009, H.R. 977. The bill, which would amend the Commodity Exchange Act (CEA), reflects several substantive changes from the draft bill, which was the subject of hearings before the Committee last week. Among the more significant changes, the revised bill would preclude the Federal Reserve Board from regulating over-the-counter derivatives transactions. In addition, rather than prohibiting "naked" credit default swaps (CDS) as originally proposed, the revised bill would grant the Commodity Futures Trading Commission the authority to suspend the trading of certain CDS, provided that (i) the President does not disapprove, (ii) the suspension applies only to CDS that are related to securities suspended by the Securities and Exchange Commission from short selling, and (iii) such CDS are purchased by persons who are not reducing an existing credit risk directly related to the CDS reference entity or its obligations. Further, the CFTC would be directed to establish speculative position limits only for physically deliverable commodities, rather than all commodities as originally proposed. Finally, the proposed legislation would authorize the CFTC to prosecute criminal violations of the CEA if the Attorney General had declined to do so, which would expand the CFTC's current authorization to prosecute violations of the CEA and CFTC regulations in U.S. district court and in agency administrative proceedings. Congressman Barney Frank, Chairman of the Financial Services Committee, is expected to request that H.R. 977 next be referred to that committee for consideration.

http://agriculture.house.gov/inside/legislation.html

UK Developments

FSA Consults on Short Selling Regime Changes

On February 6, the UK Financial Services Authority (FSA) issued a discussion paper (DP09/1 *Short Selling*) in which it proposed broadening the current disclosure requirement with respect to significant net short positions in financial stocks to apply to all UK listed equities. The proposed threshold is 0.50% for initial disclosure and for subsequent changes of 0.1% or more, compared with the current requirement for disclosure of 0.25% in relation to UK financial sector equities.

In June 2008 the FSA introduced a disclosure requirement with respect to issuers undertaking rights issues, as reported in the June 20, 2008, edition of *Corporate and Financial Weekly Digest*. The FSA then introduced a four-month temporary ban on establishing or increasing net short positions in UK financial stocks on September 18, 2008, as reported in the September 19, 2008, edition of *Corporate and Financial Weekly Digest*. The ban was combined with a requirement for the disclosure of existing net short positions in financial stocks exceeding 0.25% of an issuer's share capital. On the expiration of the ban on January 16, 2009, it was not renewed, but the requirement for the disclosure of net short positions was extended until June 30, 2009, as reported in the January 16, 2009, edition of *Corporate and Financial Weekly Digest*. At that time the FSA announced that it would consult on proposals for a long-term regime, and DP09/1 is the result.

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The consultation period lasts until May 8, following which permanent rules will be announced.

http://www.fsa.gov.uk/pubs/discussion/dp09_01.pdf

* Click here to access the *Corporate and Financial Weekly Digest* archive.

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