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Corporate and Financial Weekly Digest

February 20, 2009

SEC/Corporate

SEC Rejects Exclusion of Shareholder Proposal Regarding Compensation Limitations for TARP Participant

On February 5, the Securities and Exchange Commission's Division of Corporation Finance rejected a request for no-action relief submitted by Regions Financial Corporation to exclude a shareholder proposal asking for reform of compensation practices and a limit to senior executive compensation in light of its receipt of funds pursuant to the Capital Purchase Program (CPP) under the Troubled Asset Relief Program.

The proposal, submitted by the Sheet Metal Workers' National Pension Fund under Rule 14a-8 of the Securities Exchange Act of 1934, stated that given Regions Financial Corporation's participation under the CPP, the board of directors and the compensation committee were urged to implement executive compensation reforms, including limits on incentive compensation and severance payments for senior executives, a requirement that a majority of long-term compensation be awarded in the form of performance-vested equity instruments, such as performance shares or performance-vested restricted shares and a prohibition on accelerated vesting for all unvested equity awards held by senior executives.

The SEC rejected Regions Financial Corporation's arguments to exclude the proposal, including on the grounds that it was vague and indefinite as the proposal appeared to impose no limitation on the duration of the specified reforms. Regions Financial Corporation's no-action request highlighted that the SEC had granted no-action relief to SunTrust Banks, Inc. in December 2008 on similar grounds for a similar proposal.

The SEC's response in Regions Financial Corporation thus appears to represent a change of position, at least applied to participants in the CPP.

http://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2009/smwnpf020509-14a8.pdf

Litigation

Single Scheme Did Not Constitute Pattern of Racketeering Activity

An individual investor in, as well as the corporate manager of, a Provincetown, Massachusetts, resort brought an action alleging, among other things, violations of federal and state RICO statutes against several other investors in the resort. The claims arose out of a series of disputes involving the ownership of the resort, as well as a string of settlement agreements whereby the defendants ultimately agreed to sell their interests in the resort to the individual plaintiff. The sale was never consummated, however, because the individual

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plaintiff was unable to obtain financing to complete the purchase, allegedly due to the defendants' wrongful interference with a senior lender that had to consent to the financing.

The District Court dismissed the complaint and the plaintiff appealed. On appeal, the 11th Circuit began its analysis by recognizing that an essential element of any RICO claim is a "pattern of racketeering activity" that must "amount to, or... otherwise constitute a threat of, *continuing* racketeering activity." The court pointed out that this requirement can be met through either "closed-ended" or "open-ended" continuity. Close-ended continuity can be established by a series of related predicate acts of racketeering occurring over a significant period of time, while open-ended continuity may be demonstrated through a showing that the acts were part of a "regular way of doing business" or were likely to be repeated in the future.

In affirming the dismissal of the complaint, the 11th Circuit held that the allegations could not establish closed-ended continuity because the alleged acts were part of a single scheme, occurring over a relatively short two-year time period, and involved only two purported victims. Similarly, the court explained that the alleged wrongdoing was not part of defendants' regular way of doing business since the allegations related to the "extraordinary act of transferring ownership interests" in the resort. In addition, because the allegations were predicated on a single scheme to drive plaintiffs from the resort's management, there was no threat of the acts being repeated. (*Ferrell v. Durbin*, No. 07-14878, 2009 WL 322049 (11th Cir. Feb. 9, 2009))

Defendant Waived Arbitration Rights by Failing to Assert Affirmative Defense

Customers of NECC Telecom (NECC), a telephone service provider, brought an action against NECC asserting, among other things, violations of the Federal Communications Act of 1934 and the Federal Communications Commission's Truth-in-Billing Act. Plaintiffs asserted that NECC's charges were inconsistent with the representations made by the telemarketer that convinced them to select NECC. NECC answered the original complaint, without asserting arbitration as an affirmative defense, but a year later, after an amended complaint was filed, moved to compel arbitration of the parties' dispute. The District Court denied the motion and NECC appealed.

The 6th Circuit Court of Appeals affirmed the decision denying the motion to compel arbitration, holding that NECC waived whatever right it had to arbitrate when it failed to plead arbitration as an affirmative defense to the original complaint, as required by Federal Rule of Civil Procedure 8(c). The court's decision was also based on the fact that NECC had participated in the litigation for a year, taking part in discovery and motion practice, without ever asserting that it had a right to compel arbitration. Finally, the court rejected NECC's argument that the filing of an amended complaint revived NECC's right to compel arbitration, finding that the new claims did not substantially alter the scope or theory of the case. (*Manasher v. NECC Telecom*, No. 07-2300, 2009 WL 361381 (6th Cir. Feb. 12, 2009))

Broker Dealer

FINRA Settles Auction Rate Securities Cases

The Financial Industry Regulatory Authority (FINRA) has reached final settlements with certain member firms to resolve charges that these member firms misled investors regarding liquidity risks associated with auction rate securities (ARS). FINRA's investigation into ARS found evidence that member firms misrepresented to their customers that ARS were liquid investments that were equivalent to cash and failed to disclose the increasing risks associated

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with ARS, including the member firms' reduced ability to support auctions in early 2008. Depending on the nature of the claim being settled and the settlement amount, member firms may have certain reporting or disclosure obligations. When determining the dollar amount for reporting an ARS settlement, member firms must include the full dollar amount that was refunded to the customer as part of a repurchase agreement, plus any other damages identified in the settlement. ARS settlement amounts may not be reduced by the actual (if it can be determined) or estimated market value of ARS. FINRA expects more settlements as ARS investigations continue.

http://www.finra.org/Industry/Regulation/Notices/2009/P117862

FINRA Adopts Rule Prohibiting Trading Ahead of Research Reports

On January 15, the Securities and Exchange Commission approved Financial Industry Regulatory Authority (FINRA) adoption of a rule prohibiting trading in a security or a derivative thereof ahead of research reports. FINRA Rule 5280 generally adopts NASD Interpretive Material (IM) 2110-4, which prohibits member firms from establishing or adjusting an inventory position in an exchange-listed security traded over-the-counter or a derivative of such security in anticipation of issuing a research report on that security.

FINRA Rule 5280 differs from NASD IM-2110-4 in three respects. FINRA Rule 5280:

- covers inventory positions for any security (including debt) or a derivative thereof, irrespective of whether the security is exchange-listed;
- applies only to member firms that establish or adjust their inventory based on non-public, advance knowledge of a research report in that security; and
- eliminates the option to establish internal controls to manage the information flow between the research and trading departments, and instead requires member firms to establish policies and procedures that restrict or limit the information flow between their research department personnel, or other persons with non-public, advance knowledge of a research report, and trading department personnel.

The effective date of the rule change is April 20.

http://www.finra.org/Industry/Regulation/Notices/2009/P117852

CBOE Proposes to Eliminate Restrictions on Members Functioning as Market Makers

The Chicago Board Options Exchange (CBOE) is proposing to eliminate restrictions that prohibit members acting as principals on their own behalf or as agents on behalf of other broker-dealers or Voluntary Professionals to function as market makers. CBOE Rule 6.8C currently prohibits a member, acting as principal or as an agent, from entering or permitting the entry of orders if: (i) the orders are limit orders for the account or accounts of the same beneficial owner(s), and (ii) the limit orders are entered in such a manner that the beneficial owner(s) effectively is operating as a market maker by holding itself out as willing to buy and sell such securities on a regular or continuous basis. Although the proposal would remove broker-dealer orders and Voluntary Professional orders from these restrictions, customer orders would remain restricted because they have priority at any price over the bids and offers of non-customers. The CBOE also proposed to remove the multiple acquisition and liquidation of positions in a security during the same day from its

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consideration as to whether a beneficial owner effectively is operating as a market maker.

http://www.cboe.org/publish/RuleFilingsSEC/SR-CBOE-2009-009.pdf

Structured Finance and Securitization

STRUCTURED FINANCE AND SECURITIZATION

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President Obama Announces Homeowner Affordability and Stability Plan

On February 18, President Barack Obama announced a new Homeowner Affordability and Stability Plan that aims to reduce avoidable residential foreclosures. Although complete eligibility details will be announced on March 4 when the program begins, certain preliminary information is currently available.

First, a "Refinancing Plan" will allow homeowners with conforming loans owned or guaranteed by Fannie Mae or Freddie Mac to obtain low-cost refinancing through those institutions into 15- or 30-year fixed rate mortgage loans. In order to qualify, the loan-to-value of the new first mortgage (including refinancing costs) may not exceed 105%, and the homeowner must have sufficient income to make the new payments and have an acceptable mortgage payment history. For homeowners with second liens, the second-lien holder's consent will be required.

Second, a "Homeowner Stability Initiative" will assist borrowers who are at risk of default and foreclosure by providing incentives to mortgage lenders to modify first mortgages. In general, eligible borrowers must (i) occupy the property as a primary residence, (ii) have monthly mortgage payments that exceed 31% of their monthly gross income, and (iii) have loans with balances that do not exceed current conforming loan limits. Lenders choosing to participate must first reduce the loan interest rate so that the borrower's monthly payment does not exceed 38% of the borrower's monthly income, and then the government will match further interest reductions dollar-for-dollar to reduce the ratio to 31%. Certain up-front and ongoing incentive payments will be made to servicers, borrowers and mortgage holders. Finally, the Treasury Department will create an up to $10 billion insurance fund to provide insurance payments linked to declines in the home price index to holders of modified mortgages.

The plan also involves (i) the development by the Treasury Department of uniform guidelines for loan modifications, to be applied by all financial institutions receiving Financial Stability Plan funds, Fannie Mae, Freddie Mac and many other federal government agencies; (ii) support for "cramdown legislation" to allow bankruptcy judges to modify home mortgages that have balances below current conforming home limits; (iii) modifications to the existing Hope for Homeowners refinancing program; and (iv) increases to the Treasury's Preferred Stock Purchase Agreements with respect to Fannie Mae and Freddie Mac from $100 billion each to $200 billion each, and increases to the size of Fannie Mae's and Freddie Mac's retained mortgage portfolios by $50 billion to $900 billion.

http://www.treas.gov/initiatives/eesa/homeowner-affordability-plan/FactSheet.pdf

Federal Reserve Continues Preparation for Imminent TALF Program Launch

Federal Reserve Chairman Ben Bernanke, in a speech to the National Press Club on February 18, stated that the Term Asset-Backed Lending Facility (TALF) would begin shortly. Specifically, Bernanke said, "the Federal Reserve and the Treasury have jointly announced [the TALF program], expected to be

operational shortly, that will lend against AAA-rated asset-backed securities collateralized by recently originated student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration. Last week, in conjunction with the Treasury, we announced that we were prepared to expand significantly this facility... to encompass other types of newly issued AAA-rated asset-backed securities, such as commercial mortgage-backed securities and private-label mortgage-backed securities, as well. If this program works as planned, it should lead to lower rates and greater availability of consumer, business, and mortgage credit."

As part of ongoing efforts to provide documentation standards for the TALF, the Federal Reserve Bank of New York later released the "TALF Master Loan and Security Agreement" on February 18, a "Form of Certification as to TALF Eligibility" on February 19 and a "Form of Auditor Attestation" on February 20.

The recently expanded TALF program will provide up to $1 trillion in loans to purchasers of asset-backed securities, including securities backed by auto loans, student loans, credit card receivables, small business administration loans and commercial mortgage loans, and possibly in the future, private-label residential mortgage loans and corporate loans. A Katten *Client Advisory* describes the TALF program in greater detail.

http://www.federalreserve.gov/newsevents/speech/bernanke20090218a.htm

Financial Markets

Legislation Proposed in Senate to Reduce Speculative Trading

On February 13, Senator Carl Levin introduced the "Prevent Excessive Speculation Act," which, if enacted, would authorize the Commodity Futures Trading Commission to regulate over-the-counter derivatives transactions in energy and agricultural products, including the imposition of speculative position limits and large trader reporting requirements. The bill also would require the CFTC to review and revise the definition of "bona fide hedging transaction" as used in calculating speculative positions.

In addition, the proposed legislation would require the CFTC to establish speculative position limits for futures contracts in all energy and agricultural commodities traded on U.S. exchanges. A foreign exchange that lists an energy contract that settles against a contract traded on a U.S. exchange would not be allowed to provide direct access from the United States, unless the foreign exchange agreed to impose speculative position limits comparable to those of the U.S. exchange and to comply with certain reporting requirements. Finally, the proposed legislation would provide the CFTC with the same enforcement authority over U.S. traders on foreign exchanges that it has over traders on U.S. exchanges. The bill was referred to the Senate Committee on Agriculture, Nutrition and Forestry.

http://www.govtrack.us/congress/bill.xpd?bill=s111-447

"Let Wall Street Pay for Wall Street's Bailout Act of 2009"— Congressional Bill Proposes New Tax on Securities Transactions

On February 13, the "Let Wall Street Pay for Wall Street's Bailout Act of 2009" (Act) was introduced by U.S. Representative Peter DeFazio and referred to the House Ways and Means Committee. The Act would amend the Internal Revenue Code of 1986 (Code) by imposing a tax on substantially all securities or futures transactions effected on a national securities exchange, other trading facility or futures exchange to the extent required to recoup the net cost of the Troubled Asset Relief Program (TARP). If adopted in its proposed form, the tax could represent a material cost increase to securities and futures

FINANCIAL MARKETS

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traders who deal in any volume, such as hedge funds or prop traders, particularly those with high-frequency, high-volume quantitative strategies.

The Act inserts a new Subchapter C of Chapter 36 of the Code that imposes a tax on each covered securities transaction in an amount equal to the applicable percentage of the value of the security involved in the transaction. The "applicable percentage" is the lesser of (i) 0.25% and (ii) the percentage that would result in aggregate revenue to the Treasury equal to the net cost of TARP. A "covered securities transaction" is (i) any transaction conducted on a national securities exchange for which the exchange must pay fees under subsection (b), (c), or (d) of section 31 of the Securities Exchange Act of 1934 or (ii) any transaction subject to the exclusive jurisdiction of the Commodity Futures Trading Commission. The tax imposed by the Act will be paid by the trading facility on which the covered securities transaction occurs.

http://thomas.loc.gov/home/gpoxmlc111/h1068_ih.xml

CFTC

CFTC Approves CBOT Agricultural Delivery Instrument Limits

On February 13, the Commodity Futures Trading Commission approved a request by the Chicago Board of Trade (CBOT) to limit the number of delivery instruments an entity can hold for non-commercial purposes in grains and soybeans, soybean meal and soybean oil. The limit applies to warehouse receipts and shipping certificates, and in each case is set at that contract's spot month speculative position limit. The CBOT will provide exemptions for bona fide commercial purposes administered under existing hedge exemption procedures and for financial arrangements in which the certificates are held as collateral under third-party control.

http://cftc.gov/newsroom/generalpressreleases/2009/pr5613-09.html
http://www.cbot.com/cbot/docs/88607.pdf

Banking

OCC and OTS Expand Mortgage Performance Data Collection

On February 13, the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS, and collectively with the OCC, the Agencies) announced an expansion of the scope of mortgage performance data gathered from national banks and thrifts to include additional information with respect to mortgage loan modifications. The Agencies began a joint reporting program with respect to mortgage performance in the summer of 2008.

The additional information will be included in the Agencies' upcoming joint Mortgage Metrics Report, to be issued in March. Categories of loan modifications to be included in such report include the following: (i) modifications that increased borrowers' monthly principal and interest payment; (ii) modifications that brought no change to payments; (iii) modifications that reduced payments by 10% or less; and (iv) modifications that reduced payments by more than 10%. With respect to loans that were modified in the first and second quarters of 2008, the upcoming report will include the percentage of modifications in each of the four categories that are 60 or more days past due at six months after modification.

Future joint reports will also show trends in the types of modifications undertaken by loan servicers. According to the related press release, this information will "help inform lenders and policymakers as to what type of

CFTC

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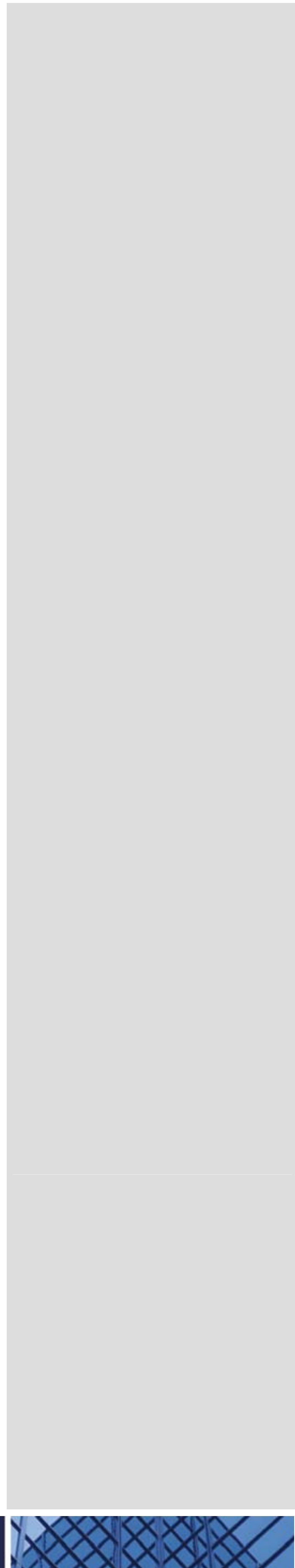
modifications work, with a particular focus on the effect of significant changes in monthly payments."

http://www.occ.treas.gov/ftp/release/2009-9.htm



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

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