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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Unveils New Web Tool to Analyze Financial Data

On February 15, the Securities and Exchange Commission announced the launch of the "Financial Explorer" on the SEC's website, an online viewer that will help investors analyze the financial results of public companies. The Financial Explorer lets investors generate financial ratios, graphs and charts depicting information derived from financial statements provided to the SEC as "interactive data" using the eXtensible Business Reporting Language (XBRL). Information including earnings, expenses, cash flows, assets and liabilities can be analyzed and compared across competing public companies. The Financial Explorer is available at www.sec.gov/xbrl.

In addition to the Financial Explorer, the SEC currently offers investors two other online viewers – the Executive Compensation viewer and the Interactive Financial Report viewer, also available at www.sec.gov/xbrl. The Executive Compensation viewer enables investors to compare executive compensation for the largest U.S. companies. The Interactive Financial Report viewer helps investors gather, analyze, and compare key financial disclosures filed voluntarily by public companies using XBRL.

The SEC is developing these tools to assist ordinary investors in analyzing financial data provided to the SEC in XBRL.

http://www.sec.gov/news/press/2008/2008-22.htm

SEC Advisory Committee on Improvements to Financial Reporting Issues Progress Report

On February 11, the Securities and Exchange Commission's Advisory Committee on Improvements to Financial Reporting issued a progress report of the Committee's developed proposals, conceptual approaches and currently identified matters for future consideration. The Committee published the interim progress report to encourage public feedback. The Committee was established to examine the U.S. financial reporting system and make recommendations to increase the usefulness of information to investors while reducing complexity. In its progress report, the Committee recommended the following proposals:

- Generally Accepted Accounting Principles (GAAP) should be based on business activities rather than industries;
- GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist;
- The addition of investors to standards-setting bodies;
- The SEC should assist the Financial Accounting Foundation with its

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governance of the Financial Accounting Standards Board (FASB);

- The SEC should encourage the FASB to further improve its standard-setting process and timelines;
- The number of parties that either formally or informally interpret GAAP and the volume of interpretive implementation guidance should continue to be reduced;
- The SEC or its staff should issue guidance reinforcing the following concepts (i) those who evaluate the materiality of an error should make the decision based upon the perspective of a reasonable investor, (ii) materiality should be judged based on how an error affects the total mix of information available to a reasonable investor and (iii) the evaluation of errors should be on a "sliding scale";
- The SEC or its staff should issue further guidance on how to correct errors;
- The SEC or its staff should develop and issue guidance on applying materiality to errors identified in prior interim periods and how to correct such errors;
- The SEC or its staff should adopt a judgment framework for accounting judgments and encourage the Public Company Accounting Oversight Board to consider similar action with respect to auditing judgments;
- The SEC should, in the future, mandate the filing of XBRL-tagged financial statements after the satisfaction of certain preconditions, with such requirements being phased-in over time; and
- The SEC should include a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information.

The progress report was posted for comment on the SEC's website and the SEC has invited comments for a period of 30 days after publication of the release in the *Federal Register*.

http://www.sec.gov/rules/other/2008/33-8896.pdf

Broker Dealer

SEC Solicits Information on Providing Investment Services to Seniors

On February 8, the Securities and Exchange Commission announced in a press release that the SEC staff, in coordination with the Financial Industry Regulatory Authority and the North American Securities Administrators Association, would be seeking information from all interested parties including investors, broker-dealers and investment advisers concerning the particular practices that have been and are being developed to responsibly deal with the increasing number of senior investors. The stated goal of the project is to identify industry practices in dealing with senior investors that appear to be effective in ensuring that firms deal fairly with senior investors, and to provide information about these practices publicly. The SEC identified the following areas for comment: marketing and advertising; account opening; product and account review; ongoing relationship review and product appropriateness; discerning and meeting the needs of customers as they age; surveillance and compliance reviews; and training for firm employees. The SEC has requested that it receive all comments from interested parties no later than April 1.

http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E8-2860.pdf

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SEC Authorizes Holding Company Subsidiary to Succeed to Contributing Company's Broker-Dealer Registration

The Securities and Exchange Commission has permitted a wholly owned Delaware subsidiary of Woodstock Financial Group, Inc., a Georgia corporation, to succeed to that company's broker-dealer registration. The SEC initially rejected the request and required Woodstock to file a new application for broker-dealer registration. Rule 15b1-3 provides that if an unregistered entity succeeds to the business of a registered broker-dealer and the succession is based solely on a change in the predecessor's date or state of incorporation, form of organization, or composition of a partnership, then succession can be effected by amending the registration of the predecessor broker-dealer on Form BD. A succession that involves a change in control is not based solely upon an event enumerated in the rule, and therefore cannot be effected by amendment. In initially denying no-action relief, the SEC staff said that the intervention of a holding company would involve a change in control. Following a second letter from counsel, the SEC staff reversed course and permitted the succession via an amendment on Form BD on the basis that the shareholders, officers, directors and key management personnel of the holding company of the unregistered entity after the succession would be the same as those of the registered broker-dealer entity.

http://www.sec.gov/divisions/marketreg/mr-noaction/2008/woodstock011408-15b1-3.pdf

ERISA

401(k) Plan Defeats "Stock Rise" Challenge

In the last few years, 401(k) and other retirement plans that allow investment in the employer's stock have faced a wave of "stock drop" litigation. In these cases, a drop in the company's stock price is followed by a class action under the Employee Retirement Income Security Act of 1974 (ERISA) on behalf of plan participants, seeking to recover market losses based on alleged violations of ERISA fiduciary duty by plan fiduciaries, such as imprudently maintaining employer stock as an investment option, or failing to provide participants with relevant information about the employer stock.

Responding to these "stock drop" cases, employers that sponsor plans that allow investment in employer stock have considered measures including appointing an independent fiduciary to monitor the employer stock fund, or even eliminating the employer stock investment option.

So what happens if the employer stock investment option is eliminated from the plan and the stock then *increases* in price? Plan fiduciaries may face a "stock rise" suit, which alleges, with perfect hindsight, that it was imprudent to eliminate the employer stock investment option, and that this led to a loss of the market gains that participants would have reaped on their investment in employer stock. We are aware of two court cases which have considered this issue, one of them quite recently, and both have dismissed the participants' claims on the basis that the plan fiduciaries involved in the process *acted prudently*, and thereby fulfilled their duty under ERISA.

These cases underscore the importance of ERISA plan fiduciaries engaging in a careful procedural process when they are engaged in the operation or administration of a plan. In the recent "stock rise" case, *Bunch v. W.R. Grace & Co.*, No. 04-11380-WGY, 2008 WL 281516 (D. Mass., Jan. 30, 2008), the 401(k) plan engaged an independent fiduciary, which had its own legal and valuation counsel, to manage the employer stock fund. The independent fiduciary's

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engagement instructed it to sell the employer stock only if it determined that "the continued holding of the stock was inconsistent with ERISA."

The independent fiduciary made such a determination and sold all employer stock held in the plan. In rejecting the participants' challenge to this decision, the court determined that the independent fiduciary properly considered various factors, and that its analysis "showed a potential for loss of value . . . comparable to knowledge of an impending collapse." Even though the company's prospects (and stock price) later improved, the independent fiduciary had engaged in a prudent process to make the decision it had been charged to make: the test under ERISA, the court said, was not whether the fiduciary "got the best possible return on the investment, but whether it considered all relevant factors in deciding the prudence of divesting the investment." See also, *Noa v. Keyser,* 519 F. Supp. 2d 481(D.N.J. 2007).

Plan sponsors and fiduciaries cannot prevent litigation under ERISA, but good fiduciary processes and procedures may enable them to defend and defeat such suits, as illustrated here.

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FDIC Issues Report Regarding Year-End 2007 Financial Results for DIF

On February 15, the Federal Deposit Insurance Corporation (FDIC) issued a report regarding its receipt of unqualified audit opinions issued by the Government Accountability Office (GAO) with respect to the financial statements of the two funds it manages – the Deposit Insurance Fund (DIF) and the FSLIC Resolution Fund (FSLIC Fund). The GAO also reported that there were "no material weaknesses or significant deficiencies identified during the period covered by the GAO's audits with respect to the FDIC's financial reporting or controls over its financial systems."

For 2007, the DIF's comprehensive income rose by $1.0 billion from a year ago and totaled $2.2 billion. According to the FDIC, this year-over-year increase was primarily due to a $611 million increase in assessment revenue, a $299 million increase in interest revenue, a higher contribution from unrealized gain/loss on available-for-sale (AFS) securities of $298 million, offset by a $42 million increase in operating expenses and a $147 million increase in the provision for insurance losses.

The FSLIC Fund's net income for 2007 was $64 million compared to a $203 million loss for 2006. According to the FDIC, this change was primarily due to an increase in criminal restitution income of $19 million, an increase in the recovery of tax benefits of $33 million, and a decrease in expenses for Goodwill/Guarini litigation settlements/judgments of $215 million.

http://www.fdic.gov/news/news/press/2008/pr08012.html

FFIEC Announces Revisions to CALL Report

On February 20, the Federal Financial Institutions Examination Council (FFIEC) announced its approval of certain revisions to the reporting requirements for the Consolidated Reports of Condition and Income (Call Reports). For the changes to become final, however, the U.S. Office of Management and Budget must approve them.

In its release, the FFIEC has proposed reporting changes "related to the 1-4 family residential mortgage loans such as reporting interest and fee income on, and the quarterly average for, such mortgages separately from the income on and the quarterly average for all other real estate loans." The FFIEC has also added new items for restructured troubled mortgages and mortgage loans in process of foreclosure. With respect to Call Report Schedule RC-P on closed-end 1-4 family residential mortgage banking activities, such schedule will be expanded to include originations, purchases, and sales of open-end mortgages as well as closed-end and open-end mortgage loan repurchases and indemnifications during the quarter. Additional changes are further described in the attached link.

The changes will be implemented as of March 31, although the reporting of certain new items (such as the changes to Call Report Schedule RC-P) will be optional for that date but required beginning June 30.

Finally, as noted in the release, the banking agencies will no longer mail paper Call Report forms and instructions to banks. Rather, such forms and instructions can be found on the FFIEC's Web site at www.ffiec.gov. and on the FDIC Web site at www.fdic.gov.

http://www.fdic.gov/news/news/financial/2008/fil08013.html.

United Kingdom Developments

UK Treasury Publishes Regulations for Recognized Covered Bonds Regime

On February 14, the UK Treasury published a summary of the responses it has received to its consultation on proposals for a UK Covered Bonds regime, as described in the November 16, 2007 edition of *Corporate and Financial Weekly Digest*. The Treasury has also published draft legislation implementing the proposed regime.

The regulations introduce a new UK regime for covered bonds complying with the UCITS Directive (85/611EC). Respondents to the consultation supported the proposals, but pointed out that new legislation should focus on quality rather than flexibility. The Treasury has made a number of amendments in light of the responses it has received.

The new regime is expected to come into force on March 6.
www.hm-treasury.gov.uk/consultations_and_legislation/ukrec_covbonds/consult_ukrec_covbonds.cfm

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EU Developments

CESR Publishes Consultation on Credit Rating Agencies and Structured Finance

On February 13, the EU Committee of European Securities Regulators (CESR) published a consultation on the role of credit rating agencies in structured finance as part of its continuing review of the role of credit rating agencies and the rating process for structured finance instruments.

CESR's consultation follows the European Commission's request to CESR for a review of several aspects of the rating process regarding structured finance instruments. CESR is now seeking market participants' views on the main issues included in the European Commission's request.

The deadline for responses is March 31.

www.cesr-eu.org/index.php?page=home_details&id=267

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CESR Publishes Advice on UCITS Key Investor Disclosures

On February 15, the Committee of European Securities Regulators (CESR) published its advice to the European Commission on the content and form of key investor disclosures for European Undertakings in Collective Investments Transferable Securities funds. The new Key Information Document (KID) is to replace the current simplified prospectus for retail investors and the Commission will now carry out market testing on the possible form and content of the KID.

CESR's advice follows its work at the request of the Commission which included a consultation launched in October 2007, as described in the October 26, 2007 edition of *Corporate and Financial Weekly Digest*.

The Commission is expected to publish final proposals Spring 2009.

www.cesr-eu.org/index.php?page=home_details&id=268

Litigation

Executive's Responsibility for SEC Filings May Be Grounds for Rule 10b-5 Liability

A federal district court denied defendant's motion for summary judgment in a Securities and Exchange Commission enforcement action seeking civil penalties for claims that the defendant, the former President and COO of a public company, violated Section 10(b) of the Securities Exchange Act of 1934 in connection with the Company's failure to disclose, among other things, the company's practice of backdating stock options in its 2002 Form 10-K. The Form 10-K was filed in January 2003, the same month in which defendant's employment ended.

Defendant moved to dismiss the claim, arguing that the SEC had not identified any conduct that could subject him to liability within the five year statute of limitations period preceding its filing of the lawsuit in June 2007. In denying the motion, the Court first ruled that the defendant's reliance on Second Circuit precedent requiring the SEC to show that defendant, *as the primary actor*, violated Section 10(b) was, misplaced. The Court noted that, under Ninth Circuit precedent, the SEC's claim would succeed if the SEC established that the defendant aided and abetted a violation of Section 10(b).

Applying the Ninth Circuit standard, the Court ruled that the SEC should be afforded the opportunity to "flesh out" its allegation that the defendant maintained responsibility for the accuracy of the 2002 Form 10-K and that such assistance supported the conclusion that the defendant aided and abetted "those who committed the primary violation by failing to disclose evidence of backdating." Because the 2002 Form 10-K was not filed until January 2003, the court reasoned that evidence could be produced to demonstrate that the defendant engaged in actionable conduct in connection with the preparation and review of the Form 10-K within the applicable statute of limitations. (*SEC v. Reyes*, 2008 WL 410614 (N.D. Cal. Feb. 12, 2008))

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Court Dismisses Securities Claims for Failure to Meet Requirements of PSLRA

Plaintiff sued defendants, a limited liability company (the LLC) and its majority owner, for, among other things, violating Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Plaintiff claimed that he purchased a 40% interest in the LLC at a substantially inflated price in reliance on the defendants' provision of materially inaccurate financial statements and projections relating to the LLC and the value of the majority owner's guarantee. Defendant moved to dismiss the federal securities law claims, arguing that the LLC interests were not "securities" to which the Securities Exchange Act of 1934 applied and, even if they were, the complaint failed to meet the pleading requirements of the Private Securities Litigation Reform Act.

After ruling that the LLC interests were "securities" under the three-prong test established by the Supreme Court in *SEC v. W. J. Howey & Co.*, the Court ruled that plaintiff's allegations were deficient under the PSLRA in multiple ways. For example, although the plaintiff repeatedly alleged that defendants made materially "inaccurate" statements, the plaintiff failed to allege *why* the statements were inaccurate, how they misled plaintiff or what the casual relationship was between the statements and the plaintiff's alleged injury. The Court further found that the plaintiff failed to allege facts "that strongly raise the inference" that defendants "acted with the intent to deceive, manipulate, or defraud plaintiff." Accordingly, the Court dismissed the federal securities claims with leave to the plaintiff to replead. (*Venezia Amos, LLC v. Favret*, 2008 WL 410163 (N.D. Fla. Feb. 12, 2008))

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