Katten Muchin Rosenman LLP

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SEC/Corporate

Commission and PCAOB Announce Internal Control Roundtable

On February 16, the Securities and Exchange Commission and the Public Company Accounting Oversight Board announced that they will sponsor a roundtable on May 10, 2006 to discuss second-year experiences with the reporting and auditing requirements of the Sarbanes-Oxley Act of 2002 related to companies' internal control over financial reporting. The roundtable discussion will include issuers, auditors, investors and other interested parties.

The Securities and Exchange Commission and the PCAOB further announced that, in addition to the roundtable, they are seeking written feedback from registrants, auditors, investors and others on their experiences with complying with the Section 404 requirements. The information that is submitted to either organization will become part of the public record of the Section 404 roundtable.

Members of the public are encouraged to provide the submissions before May 1, 2006. Further information about the meeting and how to submit feedback can be found on the SEC's website at http://www.sec.gov/news/press/2006-22.htm

Lawsuit Challenges Constitutionality of PCAOB

On February 7, a lawsuit was filed against the Public Company Accounting Oversight Board challenging the constitutionality of the formation and operation of the PCAOB, The lawsuit, which was filed by the Free Enterprise Fund along with a small Nevada accounting firm, claims that the PCAOB violates the separation-of-powers principles of the United States Constitution because the board exercises wide-ranging executive powers immune from Presidential supervision or control. Under the Sarbanes-Oxley Act of 2002, PCAOB board members are appointed by the Securities and Exchange Commission (not the President), and the Securities and Exchange Commission retains a limited ability to remove members and review PCAOB board actions. In addition, the suit claims that the PCAOB violates the appointments clause of the Constitution because PCAOB board members are not appointed by the President with the advice and consent of the Senate. Finally, the suit alleges that the Sarbanes-Oxley Act improperly and unconstitutionally delegates legislative power to the PCAOB rather than Congress, including a broad power to enact law, authority to set its own budget without constraint and authority to fund its budget through the imposition of a tax on all public companies. A copy of the complaint can be found at http://www.feinstitute.org/pdfs/FEF v PCAOB Complaint.pdf

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Banking

OTS Announces Record Year for Thrift Industry

On February 15, the Office of Thrift Supervision (OTS) announced the results of its analysis of the financial results of the country's thrift industry. The industry set an annual earnings record in 2005 and finished the year with over 99% of the industry exceeding well-capitalized standards and no thrift categorized as less than adequately capitalized.

According to the press release, "strong earnings were achieved despite a flattening yield curve that reduced the industry's aggregate net interest margin." In addition, the OTS stated that profitability and loan growth were solid for the year.

Capital ratios for thrift institutions were particularly strong. According to the OTS, the industry's capital ratio "improved to a record 9.45 percent at the end of 2005," a figure well in excess of minimum requirements.
http://www.ots.treas.gov/docs/7/776005.html

Federal Financial Regulatory Agencies Extend Comment Period on Nontraditional Mortgage Products

The federal financial regulatory agencies extended the comment period on the proposed guidance on nontraditional residential mortgage products. The action was prompted by requests from several financial institutions and trade associations for financial institutions to extend the comment period. The comment period will be extended for 30 days to March 29 from the previous date of February 27.
http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051220/attachment.pdf

Banking Agencies Issue Final Rule on Securities Borrowing Transactions

The Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency (the Banking Agencies) issued on February 22, a joint final rule on certain securities borrowing transactions. With one adjustment, the final rule adopted an interim rule published by the Banking Agencies in 2000.

The final rule specifically amends the Banking Agencies' market risk rules to revise the risk-based capital treatment for cash collateral that is posted in connection with securities borrowing transactions. Specifically, banking organizations that have adopted the market risk rule for assessing capital adequacy for trading positions (as discussed below) can exclude from risk-weighted assets receivables arising from the posting of cash collateral associated with securities borrowing transactions to the extent such receivables were collateralized by the market value of the securities, subject to the following four conditions: (1) the borrowed securities must be includable in the trading account and must be liquid and readily marketable; (2) the borrowed securities must be marked to market daily; (3) the receivable must be subject to a daily margining requirement; and (4) (x) the transaction is a securities contract, a qualified financial contract, or a netting contract as such terms are defined in various banking statutes and regulations; or (y) the bank has conducted a "sufficient legal review to reach a well-founded conclusion" that the banking organization's rights under the agreement are legal, valid, binding and enforceable.

The final rule applies only to state nonmember banks subject to the market Risk Capital Rule (banking organizations not subject to the Risk Capital Rule continue to be subject to the risk-based capital treatment set forth in the Banking Agencies' 1989 rules for their securities borrowing transactions).
http://www.fdic.gov/news/news/financial/2006/fil06017.html

The final rule was effective on February 22, 2006.

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Broker Dealer

NYSE Reminds Member Firms to Report Internal Investigations

The New York Stock Exchange, Inc. issued Information Memo Number 06-6 reminding member firms of their obligations under Rules 342.21 and 351(e). Rule 342.21 requires member firms to review trades in NYSE listed issues and financial instruments effected for the firm's account and the accounts of officers, directors, employees and members of their family, whether effected by the member firm or reported to the member firm by a third party for violations of the Securities Exchange Act of 1934 and the rules thereunder. Where there is a potential violation, the firm is to conduct an internal investigation. The Information Memo states that the rule requires member firms to have in place, written procedures to identify potentially violative trades (e.g., through the use of exception reports). Firms must establish guidelines or criteria that indicate circumstances where follow up steps will be taken and provide a reasonable basis for the firm to determine the appropriate follow up steps. Rule 351(e) requires member firms to submit, by the 15th day of the month after a calendar quarter ends, a signed written report of all internal investigations commenced in the preceding quarter, the progress of internal investigations previously commenced and the disposition of any internal investigations completed in the preceding quarter. The Information Memo states that a report must be filed even if no internal investigations commenced, were pending or were completed in the subject quarter. Even if an internal investigation is the subject of another report to the NYSE, the member firm still must make the report required by Rule 351(e), but may incorporate by reference or attach the other report. A report under Rule 351(e) also is required if a member firm begins an internal investigation at the suggestion of the NYSE, another self-regulatory organization or the Securities and Exchange Commission.
http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852571170061566A/$FILE/Microsoft Word - Document in 06-6.pdf

NYSE Files Business Entertainment Rule Proposal

On February 15, the New York Stock Exchange, Inc. filed with the Securities and Exchange Commission, proposed Rule 350A to limit business entertainment expenses (File No. SR-NYSE-2006-06). The new rule would prohibit a member firm from providing business entertainment to a customer's representative that is intended or designed to cause, or otherwise would be reasonably judged to have the likely effect of causing, such customer representative to act in a manner inconsistent with the best interest of, or fiduciary responsibility to, the customer. The member firm must have written policies and supervisory procedures reasonably designed to define forms of business entertainment that are "appropriate" and "inappropriate" using quantitative and/or qualitative venue, nature and frequency standards. The rule would require

member firms to establish guidelines relating to business entertainment that either impose specific dollar limits, or that require written supervisory approval. Detailed records of all business entertainment expenses must be maintained. Member firms would be required to notify customers (e.g., investment companies and investment advisers) via the firm's website, a disclosure document or other appropriate means that upon request detailed information regarding the manner and expense of any business entertainment provided to their employees by the member firm will be supplied. Business entertainment is defined to include any social event, meal, leisure activity or event in which a person associated with the member accompanies a customer representative. If no person associated with the member accompanies the customer representative the expense would be a "gift" or "gratuity" under existing Rule 350. Upon adoption of the proposed rule, the NYSE will issue an Information Memo clarifying what is business entertainment, when the recipient would be a customer's representative and whether the entertainment is in connection with the business of the customer.
http://apps.nyse.com/commdata/pub19b4.nsf/docs/38B4BB33F8B53BB185257116007EB409/$FILE/NYSE-2006-06.pdf

NASD Proposes Filing of Rule 15c2-11 Information

The National Association of Securities Dealers, Inc. has filed a proposal with the Securities and Exchange Commission to amend its Rule 6740. Securities Exchange Act Rule 15c2-11 requires a broker-dealer to have certain information about an issuer if its securities are non-Nasdaq securities before the broker-dealer can publish quotations for such securities. The rule would require a member firm initiating or resuming quotation of a non-Nasdaq security to file with the NASD the information required by Rule 15c2-11 at least three business days in advance of publishing any quotation. In the case of an issuer reporting through the EDGAR system a statement to that effect would have to be attached to the filing with the NASD. In all other cases, including where the issuer has not updated its EDGAR filings, the information required by Rule 15c2-11 would have to be included in the NASD filing.
http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_016036.pdf

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Litigation

Arbitrability of Securities Claim can be Determined by Arbitrator

On appeal to the Second Circuit, petitioner argued that the Court should stay a class action securities arbitration because the New York federal courts should first determine whether the claims at issue were subject to arbitration. In rejecting the petitioner's argument, the Court found that pursuant to the broad arbitration clause in the parties' contract, the parties intended that the issue of whether the claims were subject to arbitration should be committed to the arbitrator, not to the courts. In further support of its decision, the Court emphasized that the contract incorporated the rules of the American Arbitration Association, which specifically empowers the arbitrator to determine issues of arbitrability. (*JSC Surgutneftegaz v. President and Fellows of Harvard College*, No. 05-4364-CV, 2006 WL 354282 (Feb. 15, 2006)) (not for publication)

Forum Selection Clause is Enforceable Even if Contract is Void

The Seventh Circuit Court of Appeals denied petitioners' appeal from a ruling that enforced a forum selection clause which provided that jurisdiction "shall be proper only" in Texas. Petitioners sought to bring claims for violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) and federal securities law in Illinois federal court. Petitioners argued that the underlying contract containing the provision was void and unenforceable as a matter of public policy, and that, as a result, the forum selection clause was also void. The Court rejected this argument because it would place an Illinois federal court in the position of having to first determine whether a contract was void before it could determine, based on the forum selection clause, whether it should hear the case in the first place. (*Muzumdar v. Wellness International Network, Ltd.*, __ F.3d __, 2006 WL 355262 (7th Cir. Feb. 17, 2006))

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CFTC

CFTC Amends Rules to Require Electronic Filing of Commodity Pool Annual Reports

The Commodity Futures Trading Commission has adopted rule amendments to require that commodity pool annual financial reports submitted by commodity pool operators (CPOs) to the National Futures Association (NFA) be filed and affirmed electronically. The amendments eliminate the requirement that the commodity pool annual report filed with the NFA be manually signed, but require that CPOs maintain for five years a manually signed oath or affirmation for each annual report, along with documentation supporting the compilation of certain key financial balances required to be submitted to the NFA.

In addition to mandating electronic filing, the CFTC also amended other provisions of its rules applicable to CPOs with respect to financial reporting to (i) make clear that commodity pool monthly and/or quarterly account statements distributed to participants must be prepared in accordance with U.S. generally accepted accounting principles; (ii) clarify that CPOs must file a notification of a change in a public accountant for a commodity pool with the NFA; (iii) clarify that references to "segregation" made in an accountant's letter refer to the prohibition on commingling of funds of a commodity pool with the assets of any other person; and (iv) require that notifications concerning fiscal year elections or changes in fiscal year be filed solely with the NFA.

The rule amendments will become effective on March 24, 2006.
http://www.cftc.gov/files/tm/tmcpoelectronicfiling.pdf

CFTC Issues Annual Guidance Letter to Registered CPOs

The Commodity Futures Trading Commission's Division of Clearing and Intermediary Oversight has issued its annual guidance letter to registered commodity pool operators (CPOs). The 2006 letter emphasizes that commodity pool annual reports must be distributed to pool participants and filed with the National Futures Association (NFA) within 90 calendar days of the pool's fiscal year end and that applications for an extension of the distribution and filing date must be submitted to the NFA prior to the original due date and must include all required information.
http://www.cftc.gov/files/tm/tmcpoannualguidanceletter2005.pdf

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