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SEC/Corporate

SEC Releases Final Rule on Electronic Form D Filing

On February 6, the Securities and Exchange Commission released a final rule mandating the electronic filing of Form D through the Internet (after a phase-in period during which electronic filing will be voluntary), revising the requirements of Form D and revising Regulation D (promulgated under the Securities Act of 1933) to address general solicitation concerns raised by the advent of electronic filing and greater public availability of Form D information.

Between September 15, 2008 and March 16, 2009 issuers may file Form D either electronically or on paper; after March 16, 2009 electronic filing of Form D will become mandatory.

Among other things, the revisions to Form D:

- will make Form D information available in electronic form over the Internet;
- permit filers to identify all issuers in a multiple-issuer offering in one Form D filing;
- delete the current requirement to identify owners of 10 percent or more of an issuer's equity securities as "related persons";
- replace the current requirement for a business description of the issuer with a requirement to classify the issuer by industry from a standardized industry list;
- require revenue range information (or, subject to an option to decline to disclose, net asset value range information for hedge funds);
- require more specific information on the exemptions from registration claimed under the Securities Act and the Investment Company Act of 1940;
- require reporting of the date of first sale in the offering and whether it is expected to last over one year;
- require CRD numbers for individual recipients of sales compensation and affiliated broker-dealers;
- replacing current requirements on disclosure of expenses and application of proceeds with requirements only to disclose amounts paid for sales commissions and finders' fees and use of proceeds used to make payments to executive officers, directors and promoters; and
- permit a limited amount of free writing in "clarification" fields to the extent necessary to clarify certain information provided.

In addition, Rule 502(c) of Regulation D has been amended to clarify that the filing of a Form D electronically will not, in itself, violate the rule's prohibition on

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general solicitations and general advertising, so long as the information is provided in good faith and the issuer makes reasonable efforts to comply with the requirements of Form D.

http://www.sec.gov/rules/final/2008/33-8891.pdf

One Year Postponement of Auditor Attestation Requirements for Non-Accelerated Filers Proposed

On January 31, the Securities and Exchange Commission proposed to amend the temporary rules implementing Section 404(b) of the Sarbanes-Oxley Act of 2002 that require companies that are non-accelerated filers to include in their annual reports, an attestation report of their independent auditor on internal control over financial reporting for fiscal years ending on or after December 15, 2008. The proposed amendments postpone by one year the Section 404(b) auditor attestation requirements for smaller companies, and non-accelerated filers would not be required to provide the auditor's attestation report on internal control over financial reporting until the filing of annual reports for fiscal years ending on or after December 15, 2009.

The postponement will allow the SEC to complete a cost-benefit study to assess whether, under the newly issued guidance for management and the new auditing standard, the Section 404(b) auditor attestation requirements of the Sarbanes-Oxley Act are being implemented in a manner that will be cost-effective for smaller reporting companies. The study will collect and analyze extensive "real world" cost and benefit data from a broad array of companies currently complying with Section 404 under newly issued guidance for companies and auditors. The study will have two main parts:

- A Web-based survey of companies that are subject to Section 404; and
- In-depth interviews including companies that are just now becoming compliant.

The SEC will be accepting comments on the proposed extension to the auditor attestation requirement for smaller companies for 30 days after publication in the *Federal Register*.

http://www.sec.gov/rules/proposed/2008/33-8889.pdf

Broker Dealer

AMEX Permits Options Traders to Quote and Trade From Off-Floor

The Securities and Exchange Commission approved American Stock Exchange (Amex) amendments to Rule 958-ANTE to allow registered options traders to submit electronic quotations and orders from off the Amex's trading floor on a temporary basis for a maximum of 20 days during a calendar year. The proposal is designed to provide flexibility to registered options traders when they are temporarily unable to be present on the floor. A registered options trader must notify the Amex's Division of Regulation and Compliance immediately following the day or days during which he or she submits quotes and trades from off the floor, and the Amex will use its existing surveillance procedures to monitor registered options traders' temporary off-floor trading.

http://a257.g.akamaitech.net/7/257/2422/01jan20081800/edocket.access.gpo.gov/2008/pdf/E8-2139.pdf

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Broker-Dealer Fined for Prime Broker Soft Dollar, Capital Introduction and Commission Sharing Violations

SMH Capital of Houston, Texas was fined $450,000 by the Financial Industry Regulatory Authority (FINRA) for soft dollar, capital introduction and commission sharing violations in connection with its prime broker and soft dollar services for hedge funds. The soft dollar violation arose out of SMH's payment from a soft dollar account for a hedge fund of $325,000 directly to the fund manager to reimburse payments for "consulting services" and "research expense reimbursement." SMH failed to identify what services had been provided and by whom, nor did SMH ask for a copy of the underlying invoice or backup documentation. The commission sharing issue arose from a hedge fund operated by two SMH registered representatives who used SMH as the fund's prime broker.

The fund's private placement memorandum and agreement with its marketing agent and SMH stated that the registered representatives would not share in commissions from the fund's trading. Notwithstanding this, SMH and the registered representatives agreed that the two registered representatives would share in the bonus pool derived in part from this hedge fund's commissions. As part of its capital introduction service, SMH personnel prepared and disseminated hedge fund sales material that failed to adequately disclose the risks inherent in hedge fund investing. Further, these materials were not approved by a principal or maintained in SMH's files for the required three years.

http://www.finra.org/web/idcplg?IdcService=SS_GET_PAGE&siteId=5&siteRelativeUrl=%2FPressRoom%2FNewsReleases%2F2008NewsReleases%2FP037758&ssUrlPrefix=/&PrinterFriendly=1

Developments in Mutual Recognition

Mutual recognition is the concept that the Securities and Exchange Commission recognize foreign securities regimes to permit brokers and exchanges in those countries to offer securities publicly traded in those countries to U.S. investors. John White, Director of the SEC Division of Corporation Finance, addressed the concept in a January 14 speech before PLI's Seventh Annual Institute on Securities Regulation in Europe, and in a January 28 speech before the 35th Annual Securities Regulation Institute. He stated that establishing and evaluating standards for the securities involved in mutual recognition is essential. Initially, it would seem appropriate to limit trading to plain vanilla securities, such as ordinary or common equity shares of companies with a broad market following, e.g., $700 million public global float and with a track record of public trading and public disclosure, e.g., 6-12 months.

Next would be focusing on the country's issuer disclosure standards. These could include International Financial Reporting Standards as issued by the International Accounting Standards Board and the International Disclosure Standards of the International Organization of Securities Commissions. Third would be corporate governance. This would include audit committees responsible for auditor oversight, strong internal controls over financial reporting and management reports to shareholders on internal controls. He would also look to see if the home country had in place an independent entity with oversight over audit firm activities and minimizing auditor conflict of interest.

He expressed the view that mutual recognition does not apply to capital raising and offerings.

On February 1, SEC Chairman Christopher Cox and Charlie McCreevy, European Commissioner for Internal Markets and Services, issued a joint press release. In it they stated they have jointly mandated their staff to work on a possible framework for EU-US mutual recognition in 2008.

http://www.sec.gov/news/speech/2008/spch012308jww.htm

http://www.sec.gov/news/speech/2008/spch011408jww.htm

http://www.sec.gov/news/press/2008/2008-9.htm

SEC Exempts PORTAL Securities From Rule 15c2-11

The Securities and Exchange Commission has granted Nasdaq exemptive relief from Rule 15c2-11 for securities traded in the PORTAL Market, a market operated by Nasdaq to trade securities for resale pursuant to Rule 144A under the Securities Act. Rule 15c2-11 generally prohibits a broker or dealer from publishing any quotations for a security in any quotation medium unless the broker or dealer has in its records the information specified in the rule regarding the security and its issuer. PORTAL Dealers and Brokers will be able to post anonymous one- or two-sided indicative quotations in PORTAL securities that will be seen by other PORTAL Dealers and Brokers and by PORTAL Qualified Investors, i.e., Rule 144A Qualified Institutional Buyers, negotiate anonymously and execute trades in PORTAL securities, and submit trade reports in reportable PORTAL-negotiated trades through PORTAL for forwarding to TRACE and the OTC Reporting Facility, as well as for clearance and settlement through DTCC.

The SEC relied upon several representations by Nasdaq in granting the exemptive relief, including that: (i) PORTAL securities will likely be infrequently quoted given their restricted nature; (ii) the scheme of regulation established under Rule 144A and the structure of the PORTAL Market substantially achieve the disclosure and investor-protection purposes of the Exchange Act, including Rule 15c2-11; (iii) Nasdaq will reconfirm the qualifications of PORTAL Dealers and PORTAL Qualified Investors annually; (iv) PORTAL rules authorize Nasdaq to suspend or terminate the registration of any PORTAL Dealer, PORTAL Broker, or PORTAL Qualified Investor for material misstatements or omissions, rules violations or failure to make filings or pay fees; (v) quotations and last sale information in the PORTAL Market will not be disseminated to the general public; (vi) the exemption will only be available with respect to quotations in securities satisfying investment qualifications of the PORTAL Qualified Investors, i.e. Qualified Institutional Buyers under Rule 144A; and (vii) the Financial Industry Regulatory Authority currently provides and would continue to provide surveillance of trade reports in PORTAL securities that are submitted through TRACE and the OTC Reporting Facility.

The significance of this exemption is enhanced by Nasdaq's November 12, 2007 Press Release. That Release announced the formation of the PORTAL Alliance consisting of 12 major firms and Nasdaq to create an industry standard facility for trading restricted securities.

http://www.sec.gov/divisions/marketreg/mr-noaction/2007/portal073107-15c2-11.pdf

http://www.nasdaq.com/newsroom/news/newsroomnewsStory.aspx?textpath=pr2007/ACQPMZ200711120730PRIMZONEFULLFEED131151.htm&year=11/12/2007%20+7%3a30AM

Banking

Federal Reserve Releases New Proposals

On February 7, the Board of Governors of the Federal Reserve System issued for comment a proposal amending two provisions of Regulation D (Reserve Requirements of Depository Institutions) as well as making clarifying amendments to certain provisions in Regulation I (Issue and Cancellation of Federal Reserve Bank Stock). These proposals were issued to implement provisions in the Financial Services Regulatory Relief Act of 2006.

The first proposed amendment to Regulation D would give authorized Federal Reserve Member banks (which include all national banks and state chartered banks that have applied for and received approval for membership) the ability to enter into "pass-through" arrangements with respect to their reserve requirements for certain deposits and other liabilities. Pursuant to such pass-through arrangements, a correspondent institution holds required reserves in a Federal Reserve account on a pass-through basis for an institution. According to the current regulations, only non-member banks may be a party to such pass-through arrangements and member banks must maintain required reserves in the form of cash in their vaults or as a balance in an account at a Federal Reserve Bank.

The second significant proposal would eliminate the provision in the "savings deposit" definition of Regulation D limiting certain kinds of transfers from savings deposits to not more than three per month. Pursuant to this proposal, all kinds of transfers and withdrawals from a savings account must be limited to not more than six per month.

Comments on the proposals are due 45 days after publication in the *Federal Register*.

http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20080207a1.pdf

United Kingdom Developments

UK to Consult on a New "Gold Standard" for Covered Bonds and Mortgage-Backed Securities

On February 6, UK Chancellor Alistair Darling, in a speech to a trade body, addressed a number of issues relating to continued difficulties in the financial markets. He stated that one of the causes of the current credit market crisis has been the market in mortgage-backed securities, where banks repackage mortgage and other debts for resale to investors.

The Chancellor indicated that he would shortly announce a consultation on new regulations for asset-backed securities. He pledged to create a "gold standard" to enable investors to judge the quality of asset-backed securities and covered bonds. It has yet to be decided whether any such regulatory scheme will be supervised by the UK Financial Services Authority by or an industry-based self-regulating authority.

www.hm-treasury.gov.uk/newsroom_and_speeches/press/2008/press_12_08.cfm

BANKING

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FSA Publishes 2008/9 Business Plan

On February 6, the Financial Services Authority published its Business Plan for 2008/9. The plan sets out the FSA's program of work for the year ahead, in particular with respect to addressing the risks highlighted by the Financial Risk Outlook, as described in the February 1 edition of *Corporate and Financial Weekly Digest.*

The document outlines specific FSA initiatives regarding heightened supervisory oversight in areas such as firms' liquidity, adequacy of stress testing and their general operational preparedness for unexpected events.

In addition, the FSA will continue to focus on its Treating Customers Fairly program, the Retail Distribution Review and the Financial Capability Program. The FSA intends to publish in 2008 a report on firms' systems and controls for managing the risk of consumers' personal data being lost or stolen, with feedback on good practice and areas of improvement. The FSA also intends to increase penalties in its enforcement actions to create a more credible deterrent for regulated firms.

The 2008/9 budget shows an overall increase of 7.1%, resulting in a rise in FSA's Annual Funding Requirement of 6.9%. Underlying costs have increased by £11.5 million (US$ 23 million) primarily due to increased staff costs.

www.fsa.gov.uk/Pages/Library/corporate/Plan/bp2008.shtml

UK Treasury Consults on Market Abuse Regime

On February 7, the UK Treasury launched a consultation on the UK's Market Abuse regime. It focuses on areas where the UK regime is super-equivalent (*i.e.* imposes additional requirements) to those under the EU's 2003 Market Abuse Directive (MAD). The UK regime was first introduced in 2001 and was amended in 2005 upon the UK implementation of the MAD.

The UK currently has a wider definition of market abuse than that established in the MAD and the purpose of this consultation is to enable the Treasury to assess whether that wider definition remains justified. In 2005, the UK introduced "sunset clauses" on some elements of the UK regime that were super equivalent to the MAD. The provisions that are subject to such "sunset clauses" will fall away on June 30 unless they are extended. The EU will also review the MAD during 2008.

The consultation closes on May 7.

www.hm-treasury.gov.uk/media/3/2/consult_fsmamarket_abuse070208.pdf

Litigation

"Deliberate Recklessness" Standard Should Have Been Applied in Scienter Analysis

In a Securities and Exchange Commission enforcement action, a federal district court granted defendants' motions for reconsideration of the entry of summary judgment against them on claims asserted under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. In its complaint, the SEC alleged, among other things, that the defendants, a corporation and four of its former officers and directors, violated Section 10(b) and Rule 10b-5 by making false and misleading statements to the public to manipulate the price of the corporation's stock.

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In its grant of summary judgment, the court ruled that "[s]cienter is established upon proof that the defendant acted knowingly or recklessly," and that recklessness consists of "a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it." In support of their motions for reconsideration, defendants argued that the court's scienter analysis was flawed because it allowed a finding of scienter based on recklessness without any "subjective" wrongdoing. The court agreed, holding that under controlling Ninth Circuit precedent "recklessness" only constitutes scienter under §10(b) if it "reflects some degree of intentional or conscious misconduct." (*SEC v. Platforms Wireless International Corp.*, 2008 WL 281112 (S.D. Cal. Jan. 31, 2008))

Plaintiff Investors Fail to Establish Loss Causation

Dismissing plaintiff investors' securities fraud allegations against a company and four affiliated individuals, a federal district court held, among other things, that plaintiffs' amended complaint failed to plead facts sufficient to establish loss causation. Plaintiffs alleged that they paid more than the actual value of the securities at issue because they relied on defendants' misrepresentations of the company's worth. The court ruled that, even assuming the alleged misrepresentations were made, plaintiffs still failed to plead facts that could establish that the misrepresentations proximately caused their economic loss and, thus, could not satisfy the loss causation element of their claim.

The Subscription Agreements plaintiffs signed acknowledged that they had been warned about "the tenuous nature of [the defendant-company's] finances" and informed about the company's "past operating losses, its current and potential future financial problems, the constraints on its management from liquidity problems, [and] the prospect that it might never be able to implement its business plan." The court also concluded that, at the time they invested, plaintiffs knew they were investing in a "faltering company," that employees were foregoing salary payments, and that they might never be able to sell their shares. In the light of these specifically disclosed warnings, the court ruled it "impossible" for the plaintiffs to establish that defendants' alleged misrepresentations "caused" their loses, finding, to the contrary, that having decided to invest despite these warnings, "their economic losses are theirs to bear." (*Majer v. Sonex Research, Inc.,* 2008 WL 282257 (E.D. Pa. Jan. 31, 2008))

CFTC

U.S. Department of Justice Challenges Exchange-Controlled Clearing Organizations

In a memorandum filed with the Department of the Treasury in connection with that agency's Review of the Regulatory Structure Associated with Financial Institutions, the U.S. Department of Justice (DOJ) has proposed that the Treasury "undertake a careful and objective review of exchange-controlled clearing of financial futures, the regulatory structure that underlies it, and its alternatives." Citing the unsuccessful efforts of BrokerTec, Eurex and LIFFE to compete with established U.S. financial futures markets, DOJ concluded that exchange-controlled clearing organizations may unnecessarily inhibit competition among futures exchanges in the development and trading of financial futures contracts, "to the detriment of the economy and consumers."

http://www.usdoj.gov/atr/public/comments/comments.htm#dotreas

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CFTC Grants Part 4 Exemptions to CPO

The Division of Clearing and Intermediary Oversight (DCIO) of the Commodity Futures Trading Commission has granted exemptive relief to a registered commodity pool operator (CPO), granting exemptive relief from certain of the disclosure, reporting and recordkeeping requirements of CFTC Regulations 4.21, 4.22 and 4.23 in connection with the operation of funds that have been structured in a manner similar to exchange-traded funds and which have been listed for trading on a national securities exchange. Among other things, DCIO exempted the CPO from the requirement that it obtain an investor's signed acknowledgment of receipt of the fund's Disclosure Document based upon the availability of that Document on the Internet. The relief is conditioned upon alternative compliance with the above regulations.

http://www.cftc.gov/stellent/groups/public/@lrletter08/documents/letter/08-01.pdf

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