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Corporate and Financial Weekly Digest

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SEC/Corporate

Executive Compensation Telephone Interpretations Updated

On January 24, the Division of Corporation Finance of the Securities and Exchange Commission updated its July 1997 Manual of Publicly Available Telephone Interpretations and the March 1999 Supplement to the Manual of Publicly Available Telephone Interpretations to replace and update the guidance in each of those releases with respect to Item 402 of Regulation S-K. The newly restated guidance reflects the SEC's amendments in August and December of 2006 to the executive compensation disclosure requirements under Item 402.

The Q&A portion of the restated guidance addresses questions of general applicability, including when companies have to comply with the new Compensation Discussion and Analysis disclosure requirements and the proper calculation and presentation of information in the new Summary Compensation Table, Grants of Plan-Based Awards Table and Director Compensation Table. There is also a section in the guidance which provides interpretive responses regarding particular situations, in the more familiar telephone interpretations style.

http://www.sec.gov/divisions/corpfin/guidance/execcomp402interp.pdf

Broker Dealer

Nasdaq Amends Sponsored Access Rule

The Securities and Exchange Commission approved the request of Nasdaq Stock Market LLC to update and clarify the Rule 4611 requirements for members to provide third parties electronic access to Nasdaq's execution services (Sponsored Access). The rule change allows members to sponsor other firms that will place their Nasdaq orders through and in the name of the member firm and other sponsored accounts that will directly input orders into Nasdaq.

Members providing Sponsored Access are responsible for all activity conducted using their market participant identifier. Interpretive Material 4611–1—Sponsored Access has been added clarifying the sponsoring member's obligation to ensure that firms with Sponsored Access comply with all Nasdaq rules and operating procedures as well as the federal securities laws, and that the sponsoring member have systems and written procedures reasonably designed to achieve compliance with these obligations. IM–4611–1 states that members must continue to comply with the Nasdaq and SEC short sale rules and Regulation NMS, and that members also must fulfill their ''know your customer'' obligations.

SEC/CORPORATE

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IM–4611–1 also states that members must continue to satisfy any limit order protection and display obligations that arise from limit orders submitted by sponsored firms. Sponsoring and sponsored firms also must enter into specified forms of agreements with Nasdaq.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-543.pdf

NASD Proposes to Change Application of Rule 2790

The Securities and Exchange Commission published proposed amendments to NASD Rule 2790 to expand the exemption on offering IPO securities to restricted persons at the direction of the issuer. One of the proposals exempts IPOs sold entirely on a non-underwritten basis, where no broker-dealer solicits or sells any new issue securities in the offering, and where no broker-dealer has any involvement or influence, directly or indirectly, in the issuer's allocation decisions with respect to any of the new issue securities in the offering. The other proposal will prohibit the allocation of issuer-directed securities to broker-dealers.

Generally, NASD Rule 2790 seeks to ensure that in the initial public offering process: (i) member firms make bona fide public offerings of securities at the offering price; (ii) member firms do not withhold securities in an initial public offering for their own benefit or use such securities to reward persons who are in a position to direct future business to member firms; and (iii) industry insiders, including member firms and their associated persons, do not take advantage of their insider position to purchase new issues for their own benefit at the expense of public customers.

http://www.sec.gov/rules/sro/nasd/2007/34-55128.pdf

Investment Adviser Deregistration Grace Period Expires Feb. 1

In an August 10, 2006 no-action letter to the American Bar Association Subcommittee on Private Investment Entities, the Securities and Exchange Commission staff granted no-action relief to investment advisers to hedge funds wishing to deregister following the decision of *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir., 2006). The *Goldstein* decision vacated Rule 203(b)(3)-2 under the Investment Advisers Act of 1940, which required hedge fund advisers to treat hedge fund investors as "clients" for purposes of determining the availability of the 14 client exemption from registration under section 203(b)(3).

In the no-action letter, the SEC stated that it would not recommend enforcement action against an investment adviser that registered as a result of 203(b)(3)-2 and that withdraws from registration in reliance on the Section 203(b)(3) exemption without regard to whether the adviser (i) held itself out generally to the public while it was registered, and/or (ii) had more than 14 clients while registered (counting each private fund as a single client).

Investment advisers that qualify for the Section 203(b)(3) exemption and are currently registered and wish to deregister in reliance on the no-action letter must withdraw their registration with the SEC no later than February 1.

http://www.sec.gov/divisions/investment/noaction/aba081006.pdf

SEC Extends Regulation NMS Compliance Dates

The Securities and Exchange Commission Regulation NMS Rule 610 requires, among other things, fair and non-discriminatory access to quotations and requires trading centers to establish, maintain and enforce written policies and procedures reasonably designed to prohibit members from locking or crossing markets. Rule 611 prohibits trade-throughs, which are trades in a security in one market at prices inferior to those for the same security in another market. The trading phase date for Rule 611 trade-through protection will now commence on March 7. The pilot stock phase date for compliance with Rules 610 and 611 for 250 NMS stocks will now commence on July 9. The all stocks phase date for full industry compliance will now commence on August 28 and must be completed by October 8.

http://www.sec.gov/rules/final/2007/34-55160.pdf

United Kingdom Developments

FSA Announces Financial Crime and Intelligence Division

The Financial Services Authority (FSA) announced on January 22 that it had established a new Financial Crime and Intelligence Division with an initial staff of 55. The division, headed by Philip Robinson, former FSA Head of Regulatory Transactions, will focus on the risks posed by financial crime to the UK's financial sector -- particularly from breaches of information security and other "high tech" crime. The division will, in conjunction with other regulators and law enforcement agencies: (i) examine the risks facing consumers from increasing information security; (ii) measure the impact of financial crime; and (iii) identify, assess and manage criminal threats in the UK's financial sector.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/008.shtml

Treasury Consultation on Draft Money Laundering Regulations

The UK Treasury published a second consultation document on its draft Money Laundering Regulations 2007 (designed to implement the European Union's Third Money Laundering Directive) on January 22. This is a follow-up to an initial consultation in July 2006 and includes a revised regulatory impact assessment as well as the full text of the draft regulations. The Directive is required to be implemented by December 15.

http://www.hm-treasury .gov.uk/consultations_and_legislation/money_laundering_directive/consult_thirdmoney_2007.cfm

W Deb MVL Plc Fined for Systems and Controls Inadequacies

The Financial Services Authority (FSA) has fined W Deb MVL Plc (WDM) approximately $1.1 million for widespread failings in its systems and controls during the four and a half years between December 2001 and May 2005.

The primary result of its failures was that WDM was unable to monitor its own financial position or to comply with its financial reporting requirements. This led to it making total provisions of £66.3 million (at today's exchange rate approximately $129.3 million) in its accounts for 2004 and 2005 in respect of assets viewed as irrecoverable. These provisions in turn led to concerns about the firm's solvency and to its

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former parent company waiving loans totaling $113 million to ensure it remained adequately capitalized. WDM has since been sold in an agreed manner that would allow for the orderly migration of the business and formal close down of the firm and its business being wound up by its new parent company.

The FSA found that WDM had breached several of the FSA Principles for Business as well as relevant FSA rules on client money as it had:

- failed to act appropriately on repeated warning signals about the systems and controls failings identified by both internal and external auditors over a four and a half year period (Principle 2);

- failed to establish and maintain accurate accounting records capable of producing the required statutory accounting and regulatory reports (Principle 3);

- failed to establish and maintain adequate systems and controls and/or records in relation to its accounts, cash balances and stock positions; (Principle 3);

- failed to establish and maintain effective client money procedures leading to its failure to carry out the calculation and segregation of client money for the period from November 1, 2004 to March 31, 2005 and failed to inform the FSA it had not carried out the client money calculation for that period ((Principles 3, 10 and 11).

Although there was no evidence that any clients had suffered any actual loss, the nature and extent of the firm's failings warranted a substantial fine. By agreeing to settle at an early stage of the FSA investigation WDM qualified for a 30% discount under the FSA's Executive Settlement Scheme as a result of which the fine was reduced from £800,000 to £560,000.

In determining the level of penalty the FSA also took account of the fact that WDM and its former parent identified potential regulatory issues at the firm in 2005 and acted properly and responsibly in reporting these to the FSA. Further WDM and its former parent (as well as its new parent) had been open and co-operative with the FSA in bringing the matter to a prompt conclusion.

http://www.fsa.gov.uk/pubs/final/wdeb_15jan07.pdf

Litigation

Securities Fraud Class Action Complaint Dismissed

The United States District Court for the Southern District of New York dismissed a class action complaint for securities fraud for failure to meet the heightened pleading requirements of Rule 9(b) of the Federal Rules of Civil Procedure and the Private Securities Litigation Reform Act (PSLRA). Plaintiffs alleged that the defendant insurance company issued false and misleading statements regarding the financial performance of a certain segment of its business as part of an alleged scheme to allow insiders to sell their shares while the shares were artificially inflated.

Plaintiffs did not allege that any of the reported financial results were false but rather asserted that defendants' statements accompanying the financial reports painted an overly optimistic and misleading portrait of the business segment. As a result, plaintiffs claimed they purchased

LITIGATION

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inflated common stock that dropped in value after the company announced a decline in net income in October 2005.

On defendants' motion to dismiss, the Court held that the alleged false and misleading statements were not actionable because they were: (i) protected by the judicially-created "bespeaks caution" doctrine, under which alleged misrepresentations are immaterial as a matter of law if a reasonable investor would not consider them important in light of adequate cautionary language; (ii) "forward-looking statements" falling within the safe harbor provisions of the PSLRA because they were made without actual knowledge that the statements were false and misleading; (iii) mere projections that proved erroneous; (iv) immaterial, forward-looking expressions of generic optimism or puffery; or (v) too vague to be actionable. In addition, the Court ruled that the complaint did not allege loss causation adequately.

Similarly, the Court found that the complaint's allegations could not support claims for market manipulation or aiding and abetting, and that the control person liability claim failed because the underlying claims were not properly pleaded. (*Kemp v. Universal American Financial Corp.*, No. 05 Civ. 9883 (JFK), 2007 WL 86942 (S.D.N.Y. Jan. 10, 2007))

Summary Judgment Granted on Securities Law Claims

In a securities fraud action brought by the Securities and Exchange Commission, the United States District Court for the Southern District of New York held that the undisputed evidence established that a hedge fund and its principal defrauded the fund's clients by issuing materially false statements concerning the fund's performance and its assets.

Relying on the statement of facts submitted by the SEC, which was uncontested and which included numerous admissions made by the fund's principal, the Court found that there was no genuine dispute that the fund deceived its investors by: (i) distributing offering materials that misstated investors' redemption rights; (ii) issuing quarterly financial statements with fictitious account balances that consistently overstated the fund's rate of return; (iii) distributing newsletters to potential and existing investors that indicated the fund was performing well when it was incurring significant losses; and (iv) distributing marketing materials that grossly exaggerated the total assets and performance of the fund. In addition, the District Court found that the fund's principal had admitted that he was in an investment advisory relationship with his clients and that he knowingly distributed the materials containing the misrepresentations.

As a result, the Court granted summary judgment in the SEC's favor, ruling that the fund and its principal violated Section 10(b) of the Securities Exchange Act, Section 17(a) of the Securities Act, and Section 206 of the Investment Advisers Act. The District Court permanently enjoined defendants from future violations, ordered disgorgement of more than $15.6 million, plus prejudgment interest, and ordered defendants to pay a civil monetary penalty of $15 million. (*Securities and Exchange Commission v. Haligiannis*, No. 04 Civ. 6488 (RJH), 2007 WL 106174 (S.D.N.Y. Jan. 16, 2007))

CFTC

Final Rule Adopted Requiring All FCMs to Become NFA Members

The Commodity Futures Trading Commission has adopted a final amendment to CFTC Rule 170.15(a), which requires that all persons registered with the CFTC as futures commission merchants (FCMs) become and remain members of the National Futures Association (NFA). The amended rule requires persons who choose to register as FCMs, even though they are not required to do so—such as entities that wish to qualify affiliates to act as counterparties to off-exchange forex transactions with retail customers, or persons who anticipate handling exchange-traded futures business in the future, but who do not yet do so—to also become NFA members. This amendment does not affect broker-dealers who are "notice" registered with the CFTC in connection with transactions in single stock futures and other security futures products. The revised rule will take effect on February 21.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-805.pdf

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