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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC to Consider Proposed Compensation Disclosure Rules Next Week

On July 19, the Securities and Exchange Commission announced that it will hold an open meeting on July 26 to consider whether to adopt proposed rules amending the disclosure requirements for executive and director compensation, related party transactions, director independence and other corporate governance matters, and security ownership of officers and directors. The Commission will also consider whether to adopt final rules requiring that disclosure under the amended items generally be provided in plain English.

The Wall Street Journal reported July 20 that the SEC is likely to remove the so-called "Katie Couric clause" from the proposed rules, which would have required companies to disclose the pay of as many as three non-executives whose total pay exceeded that of the top five executives of a company. Aside from the removal of the "Katie Couric clause", the Journal reported that the new disclosure rules are expected to largely reflect the proposed rules, including new requirements for a table that will have a column showing an executive's total compensation, a requirement that companies provide a monetary value of stock option grants to top executives, a lower threshold for disclosing perquisites and new disclosure tables for director pay and retirement plans.
(http://www.sec.gov/news/digest/2006/dig071906.txt; The Wall Street Journal, July 20, 2006, Page C1)

Casey Sworn in as SEC Commissioner

On July 17, Kathleen L. Casey was sworn in as a Commissioner of the Securities and Exchange Commission by Chairman Christopher Cox. Prior to being appointed Commissioner, Ms. Casey spent 13 years on Capitol Hill, serving as Staff Director and Counsel of the Senate Banking, Housing, and Urban Affairs Committee. Ms. Casey was primarily responsible for guiding the Chairman's and Committee's consideration of, and action on, issues affecting economic and monetary policy, international trade and finance, banking, securities and insurance regulation, transit and housing policy, money laundering and terror finance.
http://www.sec.gov/news/press/2006/2006-118.htm

FASB to Reconsider Accounting Standards for Leasing

On July 19, The Financial Accounting Standards Board announced that it had added to its agenda a project to reconsider the current accounting standards for leases. The goal of that project is to insure that investors and other users of financial statements are provided useful, transparent, and complete information about leasing transactions. The decision to add a leasing project, which will be conducted

jointly with the International Accounting Standards Board, which sets accounting rules for Europe and some countries outside of Europe, reflects the Board's concern that the current accounting in this area does not clearly portray the resources and obligations arising from lease transactions. The current U.S. accounting standard in this area, FAS 13, Accounting for Leases, was established in 1976 and, according to the FASB announcement, while that standard represented a significant improvement at the time, lease arrangements have evolved considerably over the past 30 years and the standards are outdated.
http://www.fasb.org/news/nr071906.shtml

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Broker Dealer

The SEC Proposes Amendments to Regulation SHO

Regulation SHO, which became effective on January 3, 2005, implemented several significant changes to the rules governing short sales. Among other things, Regulation SHO requires that persistent fail to deliver positions be closed out for securities in which a substantial amount of fails to deliver have occurred (also known as threshold securities). The mandatory close-out provision includes two exceptions: (1) the "grandfather exception," which excepts fail to delivers established prior to a security becoming a threshold security; and (2) the "options market maker exception," which excepts any fail to deliver in a threshold security resulting from short sales effected by a registered options market maker to establish or maintain a hedge on options positions that were created before the underlying security became a threshold security. The proposed amendments would eliminate the grandfather exception by requiring that previously grandfathered fail to deliver positions in a security that is on the threshold list on the effective date of the amendment be closed out within 35 settlement days, and if a security becomes a threshold security after the effective date, any fails to deliver in that security that occurred prior to the security becoming a threshold security would be subject to the mandatory close-out provision. Further, under the proposed amendment registered options market makers would be able to continue to keep open fail positions in threshold securities that are being used to hedge options positions, including adjusting such hedges, if the options positions that were created prior to the time that the underlying security became a threshold security have not expired or been liquidated. However, once the security becomes a threshold security and the specific options position has expired or been liquidated, such fails would be subject to a mandatory close out requirement.

The Securities and Exchange Commission has requested submission of comments on the proposed amendments on or before September 19.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/pdf/06-6386.pdf

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Banking

Agencies Propose Rules on Identity Theft Red Flags and Notices of Address Discrepancy

The federal financial institution regulatory agencies (and the Federal Trade Commission) are soliciting comments on a Notice of Proposed Rulemaking (NPRM) concerning identity theft "red flags" and address discrepancies. The NPRM implements sections 114 and 315 of the Fair and Accurate Credit Transactions Act of 2003.

The regulations would require each financial institution and creditor to develop and implement an identity theft prevention program that includes policies and procedures for detecting, preventing, and mitigating identity theft in connection with account openings and existing accounts. The proposed regulations include guidelines listing patterns, practices, and specific forms of activity that should raise a "red flag" signaling a possible risk of identity theft. Under the proposed regulations, an identity theft prevention program established by a financial institution or creditor would have to include policies and procedures for detecting any "red flag" relevant to its operations and implementing a mitigation strategy appropriate for the level of risk.

The proposed regulations would also require credit and debit card issuers to develop policies and procedures to assess the validity of a request for a change of address followed closely by a request for an additional or replacement card.

Additional proposed regulations would require users of consumer reports to develop reasonable policies and procedures that they must apply when they receive a notice of address discrepancy from a consumer reporting agency.

Comments on the NPRM are due no later than 60 days after publication in the Federal Register, which is expected shortly.
http://www.federalreserve.gov/boarddocs/press/bcreg/2006/20060718/attachment.pdf

Finance Board Issues New Corporate Governance Guidance for Federal Home Loan Banks

The Federal Home Finance Board, the regulator of the 12 member Federal Home Loan Banks (each, a Bank), issued a final rule on July 12, related to the director election process for each Bank. Specifically, the Board adopted a rule, proposed in April 2006, that permits each Bank to do a board-directed assessment of the skills and knowledge-set it deems necessary to operate effectively and provide such information to its members in a brief statement that accompanies the nomination and ballots for Bank board seats. By providing members with the outlines of the experience and skills-set each Bank's board believes necessary, the Board believes the corporate governance process will be enhanced at each Bank.

It should be noted that the board assessment by each Bank is authorized, but not required by the Board. If an assessment is undertaken, however, the Board does not prescribe the process by which such assessment should be undertaken.

The final rule became effective on July 18, the date the rule was published in the Federal Register. http://www.fhfb.gov/GetFile.aspx?FileID=5665

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United Kingdom Developments

FSA Issues International Regulatory Outlook Update

The Financial Services Authority has issued an update to its International Regulatory Outlook 2006 (originally released in November 2005). The update summarizes recent developments in EU regulation, provides additional detail on the implementation of the EU Markets in Financial Instruments Directive and the EU Capital Requirements Directive and records progress made in matters of international co-operation among financial services regulators.
http://www.fsa.gov.uk/pubs/iro/jul2006_update.pdf

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Litigation

Nonsignatory to Arbitration Agreement May Compel Signatories to Arbitrate

Following default on a promissory note that plaintiffs purchased from a now-bankrupt company that sold automobile insurance policies underwritten by defendant, plaintiffs asserted claims against the underwriter, alleging that it had participated in a fraudulent scheme in connection with the sale of the note. The note, which was signed by plaintiff and the issuer but not by defendant, incorporated by reference a form of subscription agreement containing a mandatory arbitration clause. Reversing the lower court's refusal to compel arbitration, the Fourth Circuit held that the purchasers were equitably stopped from denying the right of a non-signatory to enforce an arbitration provision against them, explaining that the purchasers, having premised claims on the terms of the note could not, at the same time, deny the underwriter's right to enforce the note's arbitration provision against them. (*American Bankers Insurance Group v. Long*, (2006 WL 1949429 (4th Cir. July 14, 2006))

Court Refuses to Vacate Arbitration Award

Plaintiff moved to vacate an arbitration award on the ground that, among other things, the arbitrator manifestly disregarded the law in rendering an award rejecting his claim under Connecticut's Unfair Trade Practices Act (CUTPA). Specifically, plaintiff contended that the arbitrator's reference to plaintiff as "an experienced businessman with sufficient education and business acumen to make an independent judgment as to" the purchase of a franchise from defendant, showed that the arbitrator improperly required proof that plaintiff reasonably relied on defendant's misrepresentations, despite the fact that proof of actual reliance is not required by CUTPA. In denying plaintiff's motion to vacate the award, the Court noted that parties face a "formidable burden" to demonstrate that an arbitrator knew of a governing legal principle and disregarded it altogether. In this case, the Court concluded that plaintiff fell well short of establishing an "egregious misapplication" of the law. (*Stephens v. TES Franchising, LLC*, 2006 WL 1933094 (D. Conn. July 12, 2006))

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International Organization of Securities Commissions Publishes Model Code of Ethics

The International Organization of Securities Commissions has published a code of ethics for all firms in the financial services industry that is designed to govern the conduct of financial services professionals. The code of ethics reaffirms the importance of ethical conduct and provides guidance to financial services professionals in addressing and resolving ethical issues. Specifically, the code of ethics consists of (1) six guiding ethical principles; (2) five models for resolving ethical dilemmas; and (3) recommendations for developing an effective ethics education and training program for financial services professionals.
http://www.iosco.org/library/pubdocs/pdf/IOSCOPD217.pdf

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