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Corporate and Financial Weekly Digest

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SEC/CORPORATE

Obama Administration Proposes Credit Rating Agency Regulation Reform Legislation

On July 21, the Treasury Department delivered proposed legislation to Capitol Hill amending Section 15E of the Securities Exchange Act of 1934 which would increase transparency, tighten oversight and reduce reliance on credit rating agencies, as well as reduce conflicts of interest at credit rating agencies and strengthen the authority of the Securities and Exchange Commission over and supervision of credit rating agencies. The proposed legislation would make the following changes:

<u>Conflicts of Interest</u>

- Bar rating agencies from consulting issuers that they also rate
- Strengthen disclosure and management of conflicts of interest which would affect how a credit rating agency is paid, its relationships with businesses and various affiliations
- Require disclosure of fees paid by the issuer for a particular rating as well as the fees paid by the issuer to the credit rating agency for the prior two years
- If a rating agency employee is hired by an issuer, require a review of an issuer's ratings for the prior year to confirm no conflicts of interests influenced the ratings agency employee involved with the issuer's rating
- Designate a compliance officer who reports directly to the senior officer or the board of directors of the rating agency

<u>Transparency and Disclosure</u>

- Require disclosure of preliminary ratings to reduce "ratings shopping" where an issuer may solicit ratings from several agencies and only pay for and disclose the highest rating it receives
- Require different symbols to be used to differentiate the risks of structured products such as asset-backed securities from corporate securities to highlight disparate risks
- Require qualitative and quantitative disclosure of the risks measured in a rating, including a report which provides assessment in a manner which allows investors to compare data across different securities and institutions

<u>Strengthen SEC Supervision of Credit Rating Agencies</u>

- Establish a dedicated office within the SEC for supervision of rating agencies
- Institute mandatory registration for all credit rating agencies
- Require SEC examination of internal controls and methodologies of credit rating agencies

<u>Reduce Reliance on Credit Rating Agencies</u>

- Institute a President's Working Group review of the current regulatory use of ratings to identify potential to eliminate rating requirement
- Implement the SEC's proposal to remove references to ratings in money market mutual fund regulations
- Require the U.S. Government Accountability Office (GAO) to report on reducing reliance

<u>Support SEC Proposals on Credit Rating Agencies</u>

- Require issuers of structured products to provide same issuer information for all rating agencies
- Require rating agency disclosure of full ratings history for all issuer-paid credit ratings
- Strengthen the regulation and oversight of credit rating agencies by the SEC

In her July 22 testimony before the House Committee on Financial Services related to rating agency regulation, SEC Chairman Mary Schapiro highlighted the necessity of requiring mandatory registration by credit rating agencies. She has also directed the Commission to explore new possibilities to limit the potential for ratings shopping. Further, Chairman Schapiro noted that the Commission proposed an amendment to its rules in February 2009 which would require disclosure of ratings history for 100% of all issuer-paid credit ratings, which is included in the Obama Administration's proposed legislation. For more information on the SEC's adopted and proposed rules with respect to credit rating agencies, please see the February 6, 2009, edition of *Corporate and Financial Weekly Digest*.

For the full text of Chairman Schapiro's testimony, click here.

For the full text of the Fact Sheet on the Obama Administration's Regulatory Reform Agenda and the legislation, click here.

LITIGATION

SEC Seeks Return of CEO Profits Under SOX 304 Clawback Provision

The Securities and Exchange Commission recently filed a complaint in the U.S. District Court for the District of Arizona against Maynard Jenkins, former CEO of CSK Auto Corp. (CSK), alleging violations of section 304 of the Sarbanes Oxley Act of 2002 (SOX). Specifically, the SEC is seeking reimbursement for CSK and its shareholders of more than $4 million Jenkins received in bonuses and stock-sale profits while CSK was committing accounting fraud, requiring it to file two earnings restatements. There are, however, no allegations that Jenkins orchestrated or even participated in the fraud, apparently making this "the first action seeking reimbursement under the SOX 'clawback' provision (Section 304) from an individual who is not alleged to have otherwise violated the securities laws."

SOX Section 304(a) provides a mechanism to require CEOs and CFOs to reimburse an issuer for "any bonus or other incentive-based or equity-based compensation" as well as any "profits realized from the sale of securities of the issuer," when an issuer is required to prepare a restatement of its publicly filed financial results "due to the material noncompliance of the issuer, as a result of misconduct." The provision does not specify whether the subject executive must be involved in the "misconduct" in order to be forced to disgorge his or her bonuses, etc. The SEC has, until now, focused on executives who helped conduct the fraudulent schemes.

Read more.

Businesses Under Common Control Jointly and Severally Liable for ERISA Withdrawal

Plaintiff Unite National Retirement Fund, a multiemployer employee pension plan (the Plan), brought an action for withdrawal liability, pursuant to Sections 4201 through 4225 and 4301 of the Employee Retirement Income Security Act of 1974 (ERISA), as amended by the Multiemployer Pension Plan Amendments Act of 198 (MPPAA), against Ariela USA, Inc. (Ariela) and several other business under the common control of defendant Lee Ades (Ades).

ERISA, as amended by the MPPAA, requires an employer who withdraws from a multiemployer defined benefit pension plan to contribute "withdrawal liability" to the plan, representing that employer's proportionate share of the plan's unfunded vested benefits. Plaintiff claims that Ariela, a former garment manufacturer, withdrew from the Plan, but failed to pay the withdrawal liability it incurred. Plaintiff moved for summary judgment, seeking the withdrawal liability jointly and severally from all defendants, because, plaintiff argued, they are all trades or businesses that are, with Ariela, under Ades' common control.

In granting plaintiff's motion for summary judgment, the United States District Court for the Southern District of New York began by finding that Ariela had permanently withdrawn from the Plan, and thus was responsible for the withdrawal liability. In addressing plaintiff's argument for joint and several liability among the defendants, the court began by recognizing that ERISA classifies all trades or businesses that are under "common control" as a single employer for purposes of withdrawal liability. Thus, when withdrawal liability is imposed on an employer, all other commonly controlled trades or businesses are liable as well. In the instant case, the court found the various defendant entities constituted a "brother-sister" group of businesses, because Ades was the sole owner and proprietor of each. Accordingly, the defendants were found to be jointly and severally liable for Ariela's withdrawal liability. (*Unite National Retirement Fund v. Veranda*, Nos. 04 Civ. 9869 (BSJ), 06 Civ. 0055 (BSJ), 2009 WL 2025163 (S.D.N.Y. July 13, 2009)).

BROKER DEALER

SEC Proposes Amendments to Municipal Securities Disclosure

The Securities and Exchange Commission has published for comment proposed amendments to improve the quality and timeliness of municipal securities disclosure under Rule 15c2-12 of the Securities Exchange Act of 1934, as amended (Exchange Act).

For a broker, dealer or municipal securities dealer acting as an underwriter in a primary offering of municipal securities, the amendments would modify certain requirements regarding the information such persons must reasonably determine that an issuer of municipal securities or an obligated person has undertaken to provide to the Municipal Securities Rulemaking Board (MSRB). The amendments would: (i) require a broker, dealer or municipal securities dealer to reasonably determine that the issuer of municipal securities or an obligated person has agreed to provide notice of specified events in a timely manner no more than 10 business days after the event's occurrence; (ii) amend the list of events for which a notice is to be provided, specifically with respect to an event adversely affecting a municipal bond's tax exemption; and (iii) modify the events that are subject to a materiality determination before triggering a notice to the MSRB as well as add additional events to be disclosed under a continuing disclosure agreement. The amendments also would extend Exchange Act Rule 15c2-12 to cover securities commonly known as variable rate demand obligations, which are currently exempt from Exchange Act Rule 15c2-12. In addition, the SEC provided interpretive guidance intended to assist municipal securities issuers, brokers, dealers and municipal securities dealers in meeting their obligations under the antifraud provisions of the federal securities laws. Comments are due to the SEC on or before September 8.

Click here to read the SEC Proposing Release.

"Electronic Blue Sheet" Layout Modified to Support Option Symbology Initiative

The Securities Industry Automation Corporation has modified the record layout of the Electronic Blue Sheet (EBS) automated trading data submissions pursuant to the implementation of the Option Symbology Initiative by The Options Clearing Corporation and its participant exchanges. Under the Option Symbology Initiative, all exchange-traded options are expected to be described using explicit data elements by February 12, 2010. The modified EBS record layout is set forth in Attachment A to the July 17 Chicago Board Options Exchange (CBOE) Regulatory Circular describing the EBS record layout changes. CBOE currently accepts EBS submissions using the modified record layout, which may be used on a voluntary basis until the February 12, 2010, mandatory implementation date.

Click here to read the CBOE Regulatory Circular.

FINRA Issues Guidance Regarding FDIC's Temporary Liquidity Guarantee Program

The Financial Industry Regulatory Authority (FINRA) has issued a Regulatory Notice advising firms as to the treatment of senior unsecured debt securities issued pursuant to the Debt Guarantee Program component of the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program under Rules 15c3-1 (Net Capital) and 15c3-3 (Reserve Formula) of the Securities Exchange Act of 1934, as amended (Exchange Act). The guidance on net capital treatment discusses the haircuts to which proprietary positions in certain kinds of commercial paper and convertible and non-convertible debt securities shall be subject. The guidance on reserve formula treatment sets forth the conditions for certain kinds of commercial paper and non-convertible debt securities to be deemed a "qualified security" under Exchange Act Rule 15c3-3. The guidance is set forth in FINRA's July 15 letter to the Securities Exchange Commission, which is included as Attachment A to the Notice.

Click here to read the FINRA Regulatory Notice.

PRIVATE INVESTMENT FUNDS

SEC Proposes Measures to Curtail "Pay to Play" Practices

On July 22, the Securities and Exchange Commission voted unanimously to propose measures intended to curtail "pay to play" practices by investment advisors seeking to manage money for state and local governments, including public pension and retirement plans for government employees and 529 plans (which allow families to invest money for college). The proposals are designed to prevent investment advisors from making political contributions or hidden payments to influence their selection by government officials.

The fairness of the selection process can be undermined if elected officials or their associates ask advisors for political contributions or otherwise make it understood that only advisors who make contributions will be considered for selection. The proposed rule, which has not yet been released by the SEC, would prohibit an advisor who directly or indirectly makes a political contribution to an elected official in a position to influence the selection of the advisor from providing such advisory services (either directly or through a fund) for compensation for two years. The proposal also contains a *de minimis* provision that permits an executive or employee of an advisor to make contributions of up to $250 per election per candidate if the contributor is entitled to vote for the candidate.

It would also prohibit an advisor and certain of its employees from paying a third party, such as a solicitor or placement agent, to solicit a government client on behalf of the advisor and prohibit an advisor from doing indirectly what it could not do directly (e.g., by having a third party make political contributions on its behalf in order to circumvent the rule).

Click here for a full transcript of the SEC Chairman's remarks at the open meeting at which the vote was taken.

More information on recent state legislation prohibiting pay to play practices is available in the May 1, 2009, edition of *Corporate and Financial Weekly Digest*.

Read more.

CFTC

CFTC to Hold Open Hearings on Position Limits and Hedge Exemptions

On July 21, the Commodity Futures Trading Commission (CFTC) announced that it will hold three hearings to discuss the application of, and exemptions from, position limits in the energy markets. The CFTC is seeking input from various industry participants and academics on issues such as the consistent application of position limits across all markets and participants (including index traders, managers of exchange-traded funds, and issuers of exchange-traded notes), and the advisability of permitting exemptions from position limits for anyone other than bona fide hedgers for the conduct and management of a commercial enterprise. The hearings are scheduled for July 28, July 29 and August 5 (9:00 a.m.–1:00 p.m. EDT). They will be open to the public and, in addition, will be accessible via webcast and teleconference. The CFTC also indicated its intent to review other commodities of finite supply in future hearings.

Read more.

BANKING

Federal Banking Agencies and Farm Credit System Issue Revised Interagency Questions and Answers Regarding Flood Insurance

The federal financial institution regulatory agencies and the Farm Credit System (the Agencies), have issued updated Interagency Questions and Answers Regarding Flood Insurance. In addition, the Agencies are requesting public comment on five new questions and answers. Comments on the new questions and answers are due by September 21. The revised Interagency Questions and Answers provide information to help financial institutions meet their compliance responsibilities under the federal flood insurance laws and regulations, and to increase public understanding of flood insurance requirements. The revised Interagency Questions and Answers, originally proposed in March of 2008, supersede the 1997 Interagency Questions and Answers and take effect on September 21. However, certain guidance relating to condominium coverage applies only to loans made, extended or renewed after that date. New questions and answers, as well as substantive and technical revisions to the existing guidance, address construction loans, residential condominium loans, loan syndications and participations, private insurance policies, and mandatory civil money penalties. The Agencies also are proposing five new questions and answers for public comment that address the definition of insurable value and issues relating to force placement.

Read more.

OCC Reports Tightening of Bank Underwriting Standards

On July 21, the Office of the Comptroller of the Currency (the OCC) released its 15th annual Survey of Credit Underwriting Practices (the Survey), which compiles examiner observations and assessments of credit underwriting standards at the country's largest national banks. The Survey found that commercial and retail underwriting standards tightened for the second consecutive year following a four-year period of eased underwriting.

Despite tighter underwriting, the Survey found that risk in both the commercial and retail portfolios increased for the second consecutive year and is expected to increase over the coming year. The Survey further found that "loan production and underwriting standards were also influenced by the depressed real estate market, changes in risk appetite, refinancing concerns, and the impact that relaxed underwriting standards from prior years had on payment performance."

The Survey included the 59 largest national banks and covered the 13-month period ending March 31, 2009.

For more information, click here.

STRUCTURED FINANCE AND SECURITIZATION

New York Fed Posts Revised TALF Terms/Documents and New Subscription Dates

On July 23, the Federal Reserve Bank of New York (FRBNY) published revised versions of the Master Loan and Security Agreement, Terms and Conditions and FAQs for the Term Asset-Backed Securities Loan Facility (TALF). The changes to the MLSA were generally technical, and clarifications were made that:

- aircraft is not an eligible type of equipment-related receivables;
- potential TALF borrowers may obtain non-TALF interim financing for legacy commercial mortgage-backed securities (CMBS), so long as any such arrangement is terminated at the closing of the TALF loan; and
- potential TALF borrowers who are (a) obligors under a floorplan loan or fleet lease, or their affiliates, or (b) manufacturers or sellers of products, or providers of services, including education and insurance, which are financed by loans or leases, and their affiliates, in each case, may not borrow unless the related loans or leases constitute no more than 10% of the loans and leases backing any ABS to which the TALF loan relates.

In addition, as previously announced, the administrative fee beginning in August for TALF loans for non-mortgage related asset-backed securities (ABS) has been raised from 5 bps to 10 bps.

The FRBNY also announced that the next TALF loan subscription dates for ABS are August 6, September 3 and October 2, and for CMBS are August 20, September 17 and October 21.

Read more.

ANTITRUST

Legislative Activity to Restore Ban on Minimum Resale Price Agreements Increases

A bill that would overturn the Supreme Court's 2007 decision in *Leegin Creative Leather Products, Inc. v. PSKS Inc.* has been introduced in the U.S. House of Representatives. In *Leegin* the Court overturned a nearly century-old precedent under which minimum resale price agreements between sellers of products and their resellers were deemed *per se* illegal under U.S. antitrust law. The Court determined that such agreements should not necessarily be condemned in all instances and instead should be evaluated on a case-by-case basis under the antitrust rule of reason. That analysis involves weighing the potential efficiency and procompetitive benefits of the agreement against the potential anticompetitive harm.

Shortly after the Court's ruling, Senator Herb Kohl (D-Wis.), who chairs the Senate Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights, introduced a bill to restore the ban on minimum resale price agreements. Although it initially stalled, Senator Kohl reintroduced the bill (S. 148) on January 6 of this year. Now, Representative Henry Johnson (D-Ga.), chair of the House Judiciary Subcommittee on Courts and Competition, has introduced a bill (H.R. 3190) that mirrors the Senate bill. Thus, the push to legislatively overturn *Leegin* appears to be gaining momentum at the federal level. At the state level, Maryland has already enacted legislation banning minimum resale price agreements, and state enforcers in some other states (including New York and California) have indicated that their states' existing laws already prohibit the practice.

Businesses that implemented or entered into minimum resale price programs after *Leegin*, or are considering doing so, should monitor the status of the bills pending in the U.S. Congress and should carefully review whether the agreements create antitrust risk under state laws.

EMPLOYMENT/BENEFITS

EEOC Offers Guidance Regarding Releases in Severance Agreements

The Equal Employment Opportunity Commission (EEOC) has published guidance regarding the release of employment discrimination claims in severance agreements—specifically, claims related to age, race, sex, national origin, religion and disability. The guidance is written in a question and answer format directed at employees, but also contains useful information for employers.

The EEOC's guidance presents an overview of the law regarding releases of employment discrimination claims and the "knowing and voluntary" standard applied to such releases. Understanding the "knowing and voluntary" standard is particularly important with respect to the Age Discrimination in Employment Act (ADEA). An amendment to the ADEA, the Older Workers Benefit Protection Act (OWBPA), sets forth minimum requirements for when a release of claims under the ADEA will be deemed "knowing and voluntary." OWBPA's requirements often come as a surprise to employers, particularly the disclosure requirements for securing valid releases in connection with a reduction-in-force. These disclosures must contain detailed information concerning the factors used in making termination decisions and the job titles and ages of all individuals who were considered for terminations. Generally, all employees over the age of 40 who are terminated as part of a reduction-in-force and offered severance benefits must receive these disclosures for their waiver of claims under the ADEA to be "knowing and voluntary."

Although the EEOC's guidance fails to account for some recent developments in the law, the guidance is useful in providing employers with a basic overview of the OWBPA and when its disclosure requirements can be triggered. Employers should carefully review this section of the guidance and consult with counsel when appropriate. In the context of a reduction-in-force, complying with OWBPA's disclosure requirement is essential. If an employer runs afoul of the OWBPA, every release of age discrimination claims signed in connection with the reduction-in-force can be deemed invalid notwithstanding the employees' acceptance of severance benefits. The terminated employees could then pursue claims of age discrimination which, in the context of reductions-in-force, are often brought as class actions.

The guidance is available here.

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