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Corporate and Financial Weekly Digest

July 27, 2007

SEC/Corporate

SEC Solicits Public Comment on Role of IFRS in the U.S.

On July 25, the Securities and Exchange Commission voted unanimously to publish a Concept Release for public comment on allowing U.S. issuers, including investment companies, to prepare their financial statements using International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board. Under the SEC's current rules, U.S. issuers are required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The Concept Release is an information-seeking document that describes the policy issues and, in the form of questions, seeks public input regarding the possibility of allowing U.S. issuers to report under IFRS.

SEC Chairman Christopher Cox stated "Having a set of globally accepted accounting standards is critical to the rapidly accelerating global integration of the world's capital markets."

The current proposal follows an SEC proposal in June 2007 to eliminate the requirement that foreign private issuers using IFRS reconcile their financial statements to GAAP.

The comment period extends for 90 days after the Concept Release is published in the *Federal Register*.

http://www.sec.gov/news/press/2007/2007-145.htm

SEC Approves PCAOB Auditing Standard No. 5

On July 25, the Securities and Exchange Commission voted unanimously to approve the Public Company Accounting Oversight Board's (PCAOB) proposed Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That is Integrated With An Audit of Financial Statements (Auditing Standard No. 5), a related independence rule, and conforming amendments. The SEC also adopted a definition of the term "significant deficiency."

Auditing Standard No. 5 will replace PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements (Auditing Standard No. 2). It provides for new professional standards and related performance guidance for independent auditors to attest to, and report on, management's assessment of the effectiveness of internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002. According to the SEC, Auditing Standard No. 5:

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- Is less prescriptive than Auditing Standard No. 2.

- Makes the audit scalable - so it can change to fit the size and complexity of any company.

- Directs auditors to focus on what matters most - and eliminates unnecessary procedures from the audit.

- Includes a principles-based approach to determining when and to what extent the auditor can use the work of others.

The SEC also adopted a definition of “significant deficiency” to define this term as a deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the registrant's financial reporting. This definition is used in the context of evaluating the required communications under both Sections 302 and 404 of the Sarbanes-Oxley Act and the SEC's implementing rules.

The SEC also approved PCAOB Rule 3525, which further implements Section 202 of the Sarbanes-Oxley Act's pre-approval requirements by requiring auditors to take certain steps as part of seeking audit committee pre-approval of internal control related non-audit services. The other conforming amendments approved by the SEC update the PCAOB's other auditing standards.

The new auditing standard and other measures are expected to increase the accuracy of financial reports while reducing unnecessary costs, especially for smaller public companies.

http://www.sec.gov/news/press/2007/2007-144.htm

SEC Offers Competing Proposals on Shareholder Access to Proxies

On July 26, the Wall Street Journal reported that the Securities and Exchange Commission’s Chairman Christopher Cox and the four SEC commissioners voted to approve the submission of two competing proposals on shareholder access to proxies. Chairman Cox voted in favor of both proposals, siding with two Democratic commissioners on one proposal and siding with two Republican commissions on the second proposal. The proposals relate to the inclusion in a company’s proxy materials of shareholder proposals regarding the election of members of a company’s board of directors.

The two proposals stem from a decision by the U.S. Court of Appeals for the Second Circuit invalidating the SEC’s long standing interpretation of Rule 14a-8(i)(8) of the Securities Exchange Act of 1934 providing that a company may exclude from its proxy materials a proposal that relates to an election for a member of a company’s board of directors. In applying this rule, the SEC has determined that companies may exclude from their proxy statements proposals to establish a process for conducting contested elections outside of the SEC’s rules governing contested elections. In September 2006, U.S. Court of Appeals for the Second Circuit stated that the SEC’s interpretation was inconsistent with its prior interpretation of the rule.

One proposal, supported by the two Democratic commissioners, would require companies to include in its proxy materials proposals by shareholders who own 5% or more a company’s stock for a one year to change the company’s bylaws on the election of directors.

The other proposal, supported by the two Republican commissioners, would amend Rule 14a-8(i)(8) of the Exchange Act to codify the SEC's interpretation of the rule since 1990 to exclude from a company's proxy statement all shareholder proposals related to the election of directors including all shareholder proposed bylaws concerning director nominations.

On July 25, in a SEC open meeting, Chairman Cox stated that "By advancing two very different proposals, we will have the benefit of the full breadth of commentary about different ways of attacking this issue. By considering serious alternatives, we will have the benefit of thorough analysis of a variety of ways to accomplish our stated objectives." (*Wall Street Journal*, 7/26/07, Section C-1)

http://www.sec.gov/news/speech/2007/spch072507cc.htm

Broker Dealer

Rules Governing Annual Certification of Compliance and Supervisory Processes Amended

The National Association of Securities Dealers has amended its Rule 3013 and Interpretive Material 3013 (IM-3013), which require an annual certification by a member firm's CEO as to the adequacy of the firm's compliance and supervisory policies and procedures. The NASD requires member firms to appoint a principal to serve as chief compliance officer (CCO) and requires that the CEO meet with the CCO at least annually in connection with the certification process. Under the amended rules, a firm may appoint multiple CCOs and define their respective areas of compliance responsibility. Each CCO is responsible for satisfying all requirements under Rule 3013 and IM-3013 with respect to that CCO's assigned area of responsibility, including the requirement that each CCO meet at least annually with the CEO. The amended rules also permit member firms to appoint a single co-CEO solely for purposes of compliance with Rule 3013 and IM-3013; however, each CEO remains responsible individually for satisfying his or her own obligations under the rule.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_019469.pdf

Changes to Rules Regarding Distribution of Third-Party Research Proposed

The National Association of Securities Dealers has proposed amendments to its Rule 2711, which sets out supervisory and disclosure responsibilities with respect to the distribution of third-party research reports. The amended rule would eliminate the requirement that a member firm review the content of "independent third-party research." "Independent third-party research" is defined as a third-party research report where the third-party producing the report (i) has no affiliation or business or contractual relationship with the distributing member or its affiliates that is reasonably likely to inform the contents of its research reports and (ii) makes coverage and content determinations without input by the distributing member or its affiliates. In addition, members would not be required to review independent third-party research to ensure that appropriate disclosure is made where such research is made available either (i) upon request, (ii) through a website maintained by the member or (iii) upon customer request in connection with a solicitation by the member. For research reports that do not satisfy the definition of independent third-party research, the current third-party disclosure requirements would apply, but a member would be permitted to direct a customer to a website where the applicable disclosures could be found.

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http://www.nasd.com/web/groups/rules_regs/documents/rule_filing/nasdw_019433.pdf

NASD Delays Application of Manning Rule to OTC Equity Securities

The National Association of Securities Dealers has delayed the application of revised IM-2110-2 to OTC equity securities until November 26 to give member firms additional time to upgrade their technology to comply with the rule. IM-2110-2 sets out members' obligations under the so-called "Manning Rule," which generally prohibits members from trading ahead of customer orders for their own account. This provision was amended in early 2007 to, among other things, expand its coverage to include over-the-counter (OTC) equity securities, as defined in NASD Rule 6610. The NASD will continue to apply the requirements of NASD Rule 6541 to orders in OTC equity securities prior to the application of revised IM-2110-2. All other amendments to IM-2110-2 (not related to the inclusion of OTC equity securities) took effect on July 26.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-14359.pdf

NYSE Amends Rule 92 to Permit Certain After-Hours Trading

The New York Stock Exchange has amended its Rule 92, which prohibits NYSE members from trading for their own account ahead of, or along with, customer orders executable at the same price. Prior to the amendment, Rule 92 frequently prevented a specialist from trading after hours in any security in which the specialist was registered, if that specialist was holding unexecuted customer orders on its book, because the rule's application was not limited to market hours. As amended, Rule 92 will permit specialists to trade for their dealer accounts after hours (between the hours of 6 p.m. and 9:15 a.m. ET), notwithstanding unexecuted customer interest on the specialist's book.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-14249.pdf

Portfolio Margin Pilot Programs Extended

The National Association of Securities Dealers, the New York Stock Exchange and the Chicago Board Options Exchange have filed rule changes with the Securities and Exchange Commission in connection with the extension of their portfolio margining pilot programs. The pilot programs, which had been set to expire on July 31, allow qualifying members to compute customer margin requirements for eligible securities according to prescribed portfolio margining methodologies, which are intended to better estimate the actual risk of loss across the portfolio than existing strategy- or position-based margin requirements.

The pilot programs have been extended through July 31, 2008.

http://www.sec.gov/rules/sro/nyse/2007/34-56107.pdf

http://www.sec.gov/rules/sro/nasd/2007/34-56108.pdf

http://www.sec.gov/rules/sro/cboe/2007/34-56109.pdf

Investment Companies and Investment Advisers

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

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Information Program for Newly Registered Advisers Announced

On July 24, the Securities and Exchange Commission staff announced that it will send to newly registered advisers a “welcome letter” along with a plain language summary of the key provisions of the Investment Advisers Act. The welcome letter identifies the SEC’s local office, provides information on the resources available on the SEC’s website, and describes the SEC’s CCOutreach Program which is designed to assist chief compliance officers in fulfilling their responsibilities. The summary of key Advisers Act provisions is intended to assist registered advisers in understanding their fiduciary duties and reporting and recordkeeping requirements.

The SEC’s welcome letter is being sent primarily by email, to investment advisers who have registered during the last two years.

http://www.sec.gov/about/offices/ocie/iainfo.htm

Banking

Pilot Program Regarding Subprime Lender Supervision Announced

On July 17, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Federal Trade Commission, the Conference of State Bank Supervisors, and the American Association of Residential Mortgage Regulators announced their cooperation with respect to a pilot project to conduct “targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations.” The focus will be on non-depository subsidiaries of bank and thrift holding companies as well as mortgage brokers doing business with, or working for, these entities. Pursuant to the program, state supervisors will also conduct coordinated examinations of independent state-licensed subprime lenders and their associated mortgage brokers.

As part of the program, the agencies will “evaluate the companies’ underwriting standards, as well as senior management oversight of the risk-management practices used for ensuring compliance with state and federal consumer protection regulations and laws.” Also, as part of the program, the agencies will share information from their reviews and investigations, “take action as appropriate, collaborate on the lessons learned, and seek ways to better cooperate in ensuring effective and consistent reviews of these institutions.”

The target date for implementation is the fourth quarter of this year. At the conclusion of the pilot, the agencies will determine whether the program should be continued.

http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070717/default.htm

Banking Agencies Reach Agreement on Basel II Implementation

On July 20, The Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the Federal Deposit Insurance Corporation (collectively, the Agencies) reached an agreement regarding implementation of the Basel II Accord (established by the Basel Committee on Banking Supervision) in the United States. Basel II set forth several methodologies for determining a bank’s risk-based capital requirements for credit, market and operational risk.

The agreement retains the proposed rulemaking’s transitional floor periods and provides that after the end of the second transition year, the Agencies will publish a study that evaluates the new framework. If material deficiencies are noted, banks will not be permitted to exit the third transitional period until such deficiencies are either addressed by changes to the

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regulation or a primary supervisor disagrees with the evaluation and provides a public report stating its rationale.

The Agencies also agreed to eliminate language in the proposed rule concerning a 10 percent limitation on aggregate reductions in risk-based capital requirements and replace an earlier proposed rule to adopt the "Basel IA" option with a new proposed rule that would provide all non-core banks with the option to adopt a standardized approach under the Basel II Accord.

The agreement is expected to lead quickly to finalization of a rule implementing the advanced approaches for computing large banks' risk-based capital requirements.

http://www.federalreserve.gov/BoardDocs/press/bcreg/2007/20070720/default.htm

United Kingdom Developments

HMRC Issues Revised Statement of Practice on IME

On July 20, HM Revenue and Customs (HMRC) issued its revised Statement of Practice (SP) 1/01 *Treatment of Investment Managers and their Overseas Clients* which deals with the Investment Manager Exemption (IME). The IME provides an exemption from UK taxation for non-UK funds with an investment manager based in the UK, provided that the manager is independent. The SP (first issued in 2001) explains HMRC practice with respect to IME's qualifying conditions.

The general industry reaction to the revised SP is that it is an improvement on its predecessors. Indeed, HMRC has emphasized on page 1 of the revised SP that it is committed to maintaining a tax environment which enables non-residents to appoint UK based investment managers without the risk of liability to UK taxation, and to providing greater flexibility for investment managers and expanding the scope of exempt activities.

http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ShowContent&id=HMCE_PROD1_027709&propertyType=document

UK Treasury and FSA Jointly Consult on New Framework for Covered Bonds

On July 23, the UK Treasury and the Financial Services Authority (FSA) announced a consultation on proposals that will allow UK issued covered bonds, a class of corporate bond where interest and repayment of the principal is "guaranteed" by ring-fenced assets, to benefit from options on EU Directives.

The lack of a covered bond regime in the UK has been cited as a prime reason why the development of long-term fixed rate mortgage lending has been restricted.

The proposed framework is designed to provide the necessary underpinning for compliance with the EU's Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. For example, covered bonds that comply with the UCITS Directive benefit from higher prudential investment limits. UCITS can invest up to 25 % (rather than 5%) of their assets in the compliant covered bonds of one issuer.

In summary, the proposals would require: (i) the issuer must be a credit institution with a UK registered office, (ii) UK recognized covered bonds will

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be regulated by the FSA, (iii) bonds will be supported by an asset pool, (iv) the asset pool must have sufficient collateral to cover bondholder claims throughout the whole term of the bond, and (v) bondholders must have a priority claim on the asset pool in the event of insolvency.

The consultation period ends on October 15.

http://www.fsa.gov.uk/pubs/cp/cp_bonds_hmt.pdf

FSA Sets Out Good Practice for Managing Compliance Risk

On July 25, the Financial Services Authority (FSA) published its observations on good practices for managing compliance risk in major investment banks. FSA is promoting an integrated approach to the effective management of compliance risk that takes into account the size and complexity of a firm's business and is based upon senior management engagement. FSA will refer to these good practices when engaging with FSA regulated entities.

The good practices are grouped into six areas: (i) having a clear understanding of what is meant by compliance risk, (ii) establishing a compliance culture, (iii) involving senior management, (iv) establishing a compliance risk assessment methodology, (v) compliance monitoring, and (vi) evaluating the effectiveness of compliance performance.

http://www.fsa.gov.uk/pubs/ceo/compliance_risk.pdf

EU Developments

CEBS Approves International Financial Reporting Amendments

On July 25, the Committee of European Banking Supervisors (CEBS) approved amendments to its Guidelines on Financial Reporting, which provides guidance on international financial reporting standards.

The current Guidelines were released in December 2006 and are part of CEBS's ongoing efforts to streamline financial reporting requirements in the European Union.

http://www.c-ebs.org/press/24072007CP06rev.htm1.htm

Litigation

Third Circuit Holds That Plaintiffs in Derivative Action May Amend Complaint

Reversing the district court, the Court of Appeals for the Third Circuit held that the plaintiffs in a shareholder derivative lawsuit could use information obtained in discovery to support their claim that they were excused from making a pre-suit demand on the Board of Directors to file suit because such a demand would have been futile. The Third Circuit recognized the general rule that shareholders are not permitted to use information acquired during discovery to amend allegations concerning the futility of requiring compliance with the demand requirement, noting that the rule deters fishing expeditions and efforts to undermine the Board's authority to determine whether the claim in question should be filed.

The Third Circuit held, however, that the rule did not apply because the parties had entered into a voluntary discovery agreement that (i) permitted the plaintiffs to proceed with discovery concerning the Board's conduct with respect to the subject matter of the lawsuit and, (ii) did not preclude plaintiffs from using information obtained in such discovery to amend their complaint.

EU DEVELOPMENTS

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(*In re Merck & Co.*, 2007 WL 2049017 (3d Cir. July 8, 2007))

District Court Denies Motion to Lift Stay of Discovery

Denying plaintiffs' motion to lift the statutory stay on discovery mandated by the Private Securities Litigation Reform Act (PSLRA) pending resolution of a motion to dismiss securities fraud claims, the United States District Court for the Southern District of New York held that plaintiffs failed to identify "unique circumstances" that would permit the court to grant such relief. Under the PSLRA, discovery is stayed following the filing of a motion to dismiss unless it is necessary to preserve evidence or prevent undue prejudice. The plaintiffs sought relief from the stay of discovery to require defendants to produce to plaintiffs copies of documents they had produced to the Securities and Exchange Commission in an ongoing civil action against the same defendants. The plaintiffs argued that without such discovery they would suffer "undue prejudice" because they would be the only parties litigating against the defendants who were subject to the PSLRA discovery stay.

While recognizing that relief from the stay might be appropriate where, for example, the plaintiffs were subject to a Court-imposed deadline to pursue settlement or where there was reason to believe that the defendant's assets would be depleted during the pendency of the stay, the Court ruled that neither these nor any other circumstances constituting undue prejudice had been shown. While the plaintiffs did demonstrate that the stay would delay them from collecting information to assist in settlement negotiations and from formulating litigation strategy, the Court ruled that such consequences were an inherent part of every stay of discovery under the PSLRA and, thus, did not constitute "undue prejudice." (*380544 Canada, Inc., v. Aspen Technology, Inc.*, 2007 WL 2049738 (S.D.N.Y. July 18, 2007))

CFTC

Amendments to Confidential Treatment Request Procedures Proposed

The Commodity Futures Trading Commission has proposed to amend its procedures related to confidential treatment requests submitted by designated contract markets (DCMs), derivatives clearing organizations (DCOs), and derivatives transaction execution facilities (DTEFs) in connection with filings for new products and rule changes. The proposed rules would require DCMs, DCOs and DTEFs to submit a detailed written justification at the time the petition for confidential treatment is filed and include a separate appendix containing the confidential portion of any submitted materials.

The proposed rules would also provide the CFTC with authority to make an initial determination to grant or deny confidential status prior to receiving a Freedom of Information Act request for the documents in question. The changes are intended to allow the CFTC to weigh the potential harm that could result from releasing a portion of the submission against the benefits that flow from allowing the public to have more timely access to non-confidential information.

http://www.cftc.gov/foia/fedreg07/foi070720a.htm

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