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CORPORATE & FINANCIAL
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SEC/CORPORATE

SEC Issues a New "Accredited Investor" CDI

On July 23, the Securities and Exchange Commission's Division of Corporation Finance issued a new Compliance and Disclosure Interpretation (CDI) in connection with the change to the definition of "accredited investor" under Rules 215 and 501 of the Securities Act of 1933 mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). As reported in the July 23 edition of the *Corporate and Financial Weekly Digest*, Section 413 of the Act excludes the value of a person's primary residence from the calculation of net worth when determining an "accredited investor" under Rules 215 and 501(a)(5). CDI 179.01 (as well as CDI 255.47 which is identical), while confirming that the exclusion was effective upon enactment of the Act, also states that the SEC will issue amendments to its rules to conform them to the adjusted net worth standard in the Act. CDI 179.01 also states that while the value of the person's primary residence must be excluded when determining net worth for purposes of Rules 215 and 501(a)(5), pending implementation of the changes to the SEC rules, the related amount of indebtedness secured by the primary residence up to its fair market value may also be excluded when determining net worth for purposes of such Rules. However, indebtedness secured by the residence in excess of the value of the home should be considered a liability and deducted when determining net worth for purposes of Rules 215 and 501(a)(5).

In addition, the SEC's Division of Corporation Finance withdrew CDI 255.13, which provided that an investor may include the estimated fair market value of his principal residence as an asset for purposes of Rule 501(a)(5). The withdrawal was necessary to be consistent with Section 413(a) of the Act.

CDI 179.01 can be found here.

Katten's July 23 edition of the *Corporate and Weekly Financial Digest* can be found here.

SEC Solicits Public Comment in Connection with Regulatory Initiatives Under the Dodd-Frank Reform Bill

On July 27, Securities and Exchange Commission Chairman Mary Schapiro announced that the SEC is soliciting public comments in connection with regulatory initiatives required to be undertaken by the SEC pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act). The SEC is generally required by law to establish a public comment period at the time it proposes rules or rule amendments. However, because of the volume of new regulations required by the Act and the time constraints imposed, the public will have the opportunity to express its views (and will have access to others' views) on various topics requiring regulatory rulemaking and study under the Act *even before* the SEC proposes rules or amendments. To facilitate this process, the SEC has established a web-based platform for members of the public to submit and review comments on each of the various topics that will be subject to SEC rulemaking and study.

The SEC is also adopting new processes intended to facilitate public comment and otherwise provide greater transparency and stakeholder participation in rulemaking under the Act. While the staff of the SEC will meet with interested parties seeking a meeting, such meeting will be subject to staff availability. Moreover, the staff of the SEC reserves the right to limit the number of meetings with similarly situated parties and will limit multiple meetings with the same party. All those requesting a meeting will be required to provide an agenda of topics for discussion, which will become part of the public record. If necessary, the SEC will reach out to affected stakeholders who do not appear to be fully represented by the developing public record on a particular issue. In addition, the SEC expects to hold public hearings on selected topics.

To view the SEC's press release announcing the solicitation of public comment, click here.

To access the SEC's website for submitting and reviewing comments related to the Dodd-Frank Act, click here.

BROKER DEALER

SEC Requests Comment on Study Regarding Obligations of Brokers, Dealers and Investment Advisers

The Securities and Exchange Commission has requested public comment regarding the effectiveness of the existing standard of care for brokers, dealers, investment advisers and their associated persons when providing personalized investment advice and recommendations about securities to retail customers. As required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Act), the SEC is conducting a study on this subject and must submit a report on the study to the Senate and the House within six months after enactment of the Act. The SEC is seeking public input on a variety of issues regarding the obligations of brokers, dealers and investment advisers, particularly regarding the effectiveness of and whether there are gaps, shortcomings or overlaps in existing legal or regulatory standards of care for brokers, dealers and investment advisers when providing personalized investment advice and recommendations about securities to retail customers. At the completion of the study, the SEC will have the authority to write rules that would create a uniform standard of conduct for professionals who provide personalized investment advice to retail customers. The SEC will accept comments on or before 30 days from publication in the Federal Register.

Click here to read Securities and Exchange Commission Release No. 34-62577.

CFTC

CFTC Amends Rule Regarding Operation of Commodity Brokers in Bankruptcy

The Commodity Futures Trading Commission has announced that it will amend its Regulation 190.04(d)(2) regarding the operation of a commodity broker in bankruptcy. Currently, a bankruptcy trustee is prohibited, immediately upon the commencement of the commodity broker's bankruptcy case, from processing any new trades on behalf of customers of the commodity broker, with limited exceptions. Under the amended Regulation, bankruptcy trustees will be permitted, under appropriate circumstances as determined by the CFTC, to operate the business of the commodity broker in the ordinary course, including entering into new commodity contracts on behalf of customers.

The amendment will become effective 30 days from the date it is published in the Federal Register.

The CFTC press release can be found here.

The final rule can be found here.

NFA Sets Effective Date for Amendments to "Know-Your-Customer" Rule

The National Futures Association (NFA) has set an effective date of January 3, 2011 for changes to its Compliance Rule 2-30 and the associated Interpretive Notice, which set out "know-your-customer" and customer risk disclosure requirements for NFA member firms.

The amended rules expand Compliance Rule 2-30 to cover all customers who are not eligible contract participants (rather than covering only natural persons, as is currently the case); require futures commission merchants (FCMs) to periodically request updated account information from their active customers; require the NFA member that currently solicits and communicates with a customer (whether the clearing FCM, a separate introducing FCM, an introducing broker or commodity trading advisor) to determine, based on any updated account information received by the clearing FCM, whether additional risk disclosure to the customer is necessary; and prohibit NFA members and their associated persons from making individualized recommendations to customers who have been (or should have been) advised that futures trading is too risky for them.

The NFA notice can be found here.

LITIGATION

Forward-Looking Statements Held Non-Actionable Under Federal Securities Law

Plaintiff brought claims for federal securities fraud against defendants, alleging that defendants made false and misleading statements in a business plan which contained projections which were presented to prospective investors in a natural gas development. Plaintiff alleged that defendants used the projections to entice investors but never intended to take steps to effectuate the projections. The lower court granted defendants' judgment as a matter of law after a trial, finding that plaintiff failed to show reliance on any material misrepresentation made by defendants.

The U.S. Court of Appeals for the Fifth Circuit affirmed. It held that defendants' business plan contained only forward-looking projections of future performance which generally do not provide a basis for securities fraud. The Fifth Circuit also found that there was no basis to plaintiff's claim that the defendants knew the projections contained in the business plan were false when made. Instead, the evidence showed that defendants completed the first phase of the business plan and had been diligently working to complete the next stage.

Arkoma Basin Project Limited Partnership v. West Fork Energy Co., LLC, 2010 WL 2711086 (5th Cir. June 29, 2010)

Plaintiff Sufficiently Pled the Existence of a Securities Contract to Survive Motion to Dismiss

Plaintiff brought claims for securities fraud under Kentucky's Blue Sky Laws in the U.S. District Court for the Western District of Kentucky, alleging that defendant convinced plaintiff to invest in International Tractor Co. (ITC), a purported supplier of heavy construction equipment. Plaintiff's complaint alleged that the investments were in fact part of a Ponzi scheme perpetrated by defendant, and that plaintiff lost substantially all of his $1.6 million investment.

Defendant moved to dismiss plaintiff's securities fraud claims on a variety of grounds, including that the agreement by which plaintiff invested in ITC was not a contract for the sale of securities, as is required to state a claim under the Blue Sky Laws. Defendant argued that the "common scheme or enterprise" prong of the test for whether a contract is one for securities was not met because the complaint failed to allege any sharing or pooling of funds of individual investors, and instead alleged that plaintiff's investment was earmarked for specific purchases and was not combined with the investments of others.

In denying defendant's motion to dismiss, the court acknowledged that the precise nature of the contract entered into by the parties was not clear from the pleadings. Nevertheless, viewing the complaint in the light most favorable to plaintiff, the court found that plaintiff sufficiently pled a securities contract, by, among other things, alleging that defendant induced plaintiff to invest on the basis that plaintiff would share in the profits from ITC transactions and that other investors also put money into the firm.

Brantley v. Harris, 2010 WL 2889663 (W.D. Ky. July 21, 2010)

BANKING

Federal Agencies Issue Final Rules to Implement S.A.F.E. Act Requirements for Registration of Mortgage Loan Originators

Federal agencies issued final rules on July 28 requiring residential mortgage loan originators who are employees of national and state banks, savings associations, Farm Credit System institutions, credit unions, and certain of their subsidiaries (agency-regulated institutions) to meet the registration requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (S.A.F.E. Act). The final rules are being issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Farm Credit Administration, and National Credit Union Administration (the agencies).

The S.A.F.E. Act requires, subject to a de minimus exception, residential mortgage loan originators who are employees of agency-regulated institutions to be registered with the Nationwide Mortgage Licensing System and Registry (registry). The registry is a database created by the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators to support the licensing of mortgage loan originators by the states. As part of this registration process, residential mortgage loan originators must furnish to the registry information and fingerprints for background checks. The S.A.F.E. Act generally prohibits employees of agency-regulated institutions from originating residential mortgage loans unless they register with the registry.

The agencies' final rules establish the registration requirements for residential mortgage loan originators employed by agency-regulated institutions and requirements for these institutions, including the adoption of policies and procedures to ensure compliance with the S.A.F.E. Act and final rules. As required by the S.A.F.E. Act, the final rules also require that each residential mortgage loan originator obtain a unique identifier through the registry that will remain with that residential mortgage loan originator, regardless of changes in employment. This will enable consumers to easily access employment and other background information about registered mortgage loan originators from the registry. Under the final rules, registered mortgage loan originators and agency-regulated institutions must provide these unique identifiers to consumers.

The final rules take effect on October 1. The agencies anticipate that the registry could begin accepting federal registrations as early as January 28, 2011. Employees of agency-regulated institutions must not register until the agencies instruct them to do so. The agencies will provide an advance announcement of the date when the registry will begin accepting federal registrations, and agency-regulated institutions and their applicable employees will have 180 days from that date to comply with the initial registration requirements.

Read more.

EXECUTIVE COMPENSATION AND ERISA

DOL Issues New Rules Regarding Service Provider Fee Disclosures

On July 16, the U.S. Department of Labor (DOL) issued interim final regulations that will require certain Employee Retirement Income Security Act (ERISA) retirement plan service providers to disclose information about services performed and fees received from such plans. While the current regulations do not apply to welfare plans, the DOL has indicated that it intends to publish separate regulations requiring welfare plan disclosures at a later date.

Compliance with the regulations' disclosure requirements will be required for contractual agreements between service providers and retirement plans in order to qualify for an exemption from the prohibited transaction rules under ERISA and the Internal Revenue Code of 1986, as amended. In other words, noncompliance with the regulation would mean that the statutory exemption is not available for an agreement if a service provider is a party in interest with respect to the plan, thus making the service provider liable for taxes and penalties related to prohibited transactions. Certain plan fiduciaries may also incur liability if a prohibited transaction occurs, but the regulations contain a special provision to help diligent plan fiduciaries avoid liability.

The regulations generally apply to service providers expected to receive $1,000 or more in compensation for providing any of the following services: (i) service as a fiduciary or a registered investment advisor; (ii) certain recordkeeping or brokerage services; or (iii) other services for indirect compensation (*e.g.*, accounting, auditing, actuarial, appraisal, banking, consulting, custodial, investment advisory, etc.). Prior to entering into such agreements, or prior to any renewal or extension thereof, the service provider is required to provide plan fiduciaries with a description of (a) the services to be provided; (b) all direct and indirect compensation to be received by the service provider and how it will be distributed among its affiliates; (c) the manner in which compensation will be received; and (d) certain investment disclosures. In addition, during the term of the agreement and upon request by the plan fiduciary, the service provider must disclose all information about its compensation that is necessary for the plan to comply with is own disclosure obligations.

The regulations are expected to become effective July 16, 2011, and are applicable to all agreements for plan services regardless of whether such agreements were in place prior to such date. The DOL has invited comments on the interim final regulations (due by August 30), perhaps indicating that such regulations may change when published in their final form.

The text of the DOL's interim final regulation can be found here.

UK DEVELOPMENTS

UK Government Consults of Financial Services Reform

On July 26, HM Treasury launched a consultation (*A new approach to financial regulation: judgment, focus and stability*) on the reform of the UK financial services regulatory regime announced by the Chancellor of the Exchequer in June, as reported in the June 18, 2010 edition of *Corporate and Financial Weekly Digest*.

The Government considers that reforms must focus on three key areas: (i) macro-prudential regulation; (ii) improved prudential regulation of individual firms; and (iii) improved consumer protection and markets regulation.

The consultation document contains detailed reform proposals and the Government also proposes to establish three new regulatory bodies:

i. the Financial Policy Committee (FPC) designed to give the Bank of England increased power over macro prudential regulation and likely to be established on an interim basis before the end of 2010;
ii. the Prudential Regulation Authority (PRA), under the control of the Bank of England/FPC, to be responsible for supervising banks, other deposit-takers, broker-dealers, investment banks, insurers and certain other financial institutions. The PRA will be headed by a Deputy Governor of the Bank of England, initially the current Financial Services Authority Chief Executive, Hector Sants; and
iii. the Consumer Protection and Markets Authority (CPMA) which will regulate conduct of business.

The introduction of macro-prudential regulation is designed to correct a perceived prior lack of regulatory focus on systemic risk and the financial system as a whole.

The FPC is at the heart of the new system. Six of its eleven members will be from the Bank of England, and the Treasury will have a non-voting representative and a watching brief on behalf of the UK Government. The CPMA Chief Executive will also sit on the FPC. Along with the close cooperation between the FPC and the PRA, this is intended to ensure that potential systemic risks arising from activities monitored by the CPMA or the PRA will be taken into account in FPC decisions.

The consultation will close on October 18.

Read more.

Katten's June 18 edition of the *Corporate and Weekly Financial Digest* can be found here.

FSA Bans Three Stockbroker Directors

On July 28, the UK Financial Services Authority (FSA) banned Stephen Coles, Luke Ryan and Michael Yamoah, the three directors of Simply Trading Group Limited (STG) (a small private client advisory stockbroker) from holding any financial services senior management positions.

Coles, Ryan and Yamoah shared responsibility for the management of STG, which specialized in telephone sales of securities traded on the London Stock Exchange and higher risk securities traded on the AIM and PLUS markets, through two "appointed representatives."

The FSA investigation found that Coles, Ryan and Yamoah:

i. relied too heavily on an external compliance consultant for advice on how to run the compliance aspects of STG's business;

ii. failed to make sure that STG met regulatory requirements, including capital resources and systems and controls requirements; and
iii. failed to monitor adequately their two appointed representatives, creating a serious risk that customers would received unsuitable investment advice. This included a failure to ensure that call monitoring equipment was in place at one of the appointed representatives.

As a result of the ban imposed on its three directors, STG no longer met FSA authorization requirements and its FSA permission to conduct investment business was cancelled.

Read more.

FSA Announces Changes to its Remuneration Code

On July 29, the UK Financial Services Authority (FSA) announced plans to update its Remuneration Code to take account of new remuneration rules required under the EU Capital Requirements Directive (CRD3).

The FSA's current Code requires that firms apply 'remuneration policies, practices and procedures that are consistent with and promote effective risk management.' Although it is broadly consistent with CRD3 provisions, the FSA is required to make some changes to ensure full alignment.

The current Code applies only to the largest UK banks, building societies and broker dealers. However, the CRD3 rules will bring over 2,500 firms within the scope of the Code. This will include all banks and building societies, asset managers (including hedge fund managers), Undertakings for Collective Investments in Transferable Securities (UCITS) investment firms and stockbrokers, as well as firms that engage in corporate finance, venture capital and the provision of financial advice.

The FSA does not intend its final rules to be more stringent than the CRD3 requirements unless UK legislation to that effect is passed.

Read more.

EU DEVELOPMENTS

CESR Publishes Consultation Paper on Standardization and Exchange Trading of OTC Derivatives

On July 19, the Committee of European Securities Regulators (CESR) published a consultation paper (CESR/10-610) on the standardization and exchange trading of over-the-counter (OTC) derivatives, seeking views on a number of issues, including:

- **Exchange trading.** CESR supports providing incentives to promote the use of organized trading venues for derivatives and is consulting on whether it would be desirable to make such usage mandatory.

- **Standardization.** CESR considers that greater standardization of OTC derivatives contracts could deliver efficiency benefits, although firms should be able to retain the flexibility to customize aspects of an OTC derivatives contract such as standard valuation, payment structures and payment dates. The consultation seeks views on how standardization can be increased. CESR is also considering recommending that the European Commission take regulatory action to make the use of electronic confirmation systems mandatory for European trading of OTC derivatives.

The consultation period ends on August 16. CESR intends to send technical advice to the Commission, based on responses to the consultation, in September 2010.

Read more.

CESR Proposes Changes to MiFID Regime

On July 29, the Committee of European Securities Regulators (CESR) published advice to the European Commission after conducting a reviewing of and consultation on the EU Markets in Financial Instruments Directive (MiFID) If adopted, the reforms proposed by CESR would significantly change the EU regulatory landscape.

The advice covers the following areas:

i. **technical advice on equity markets**—improving the pre-trade transparency regime for exchanges and Multilateral Trading Facilities (MTFs); reviewing the definition of and obligations for systematic internalizers; enhancing the quality of post-trade transparency information; extending the transparency obligations to equity-like instruments; improving the regulatory framework for consolidation and addressing cost of market data; establishing a new regulatory regime for broker crossing systems; and tackling market micro-structural issues;
ii. **non-equity markets transparency**—re-defining the scope of the post-trade transparency regime for bonds; establishing a phased approach for the introduction of a post-trade transparency regime for structured finance products; extending the scope to clearing eligible sovereign CDS; enhancing the post-trade transparency of derivatives markets; and introducing pre-trade transparency requirements for non-equity financial instruments traded on exchanges and MTFs;
iii. **transaction reporting**—extending transaction reporting obligations to market members not authorized as investment firms; introducing a third trading capacity (client facilitation); requiring the collection of and defining standards for client and counterparty identifiers; and requiring the collection of client ID when orders are transmitted for execution; and
iv. **investor protection and intermediaries**—introducing mandatory requirements for recording telephone conversations and electronic communications; requiring trading venues to produce reports demonstrating execution quality; clarifying the distinction between MiFID complex and non-complex financial instruments; clarifying the scope of the definition of investment advice; and harmonizing the rules for the supervision of tied agents and related issues.

Read more.

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