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SEC/CORPORATE

NASDAQ Proposes Liberalization of Independence Exception Provisions

On May 17 the NASDAQ Stock Market LLC (Nasdaq) filed a proposed rule change with the Securities and Exchange Commission. Under current Nasdaq rules that require a listed company's audit, compensation and nominations committee to consist of "independent directors," there is an exception to allow one non-independent director to serve on such committee for up to two years. However, a listed company cannot utilize this exception for an otherwise non-independent director who has a family member who is an employee of the listed company, even if that family member is not an executive officer of the company. Nasdaq proposes to amend its listing rules to allow an otherwise non-independent director who is a family member of a non-executive employee of a listed company to serve on the listed company's audit committee, compensation committee or nominations committee under the exception referenced above.

It should be noted that a listed company's board of directors utilizing the exception must still make an affirmative determination that the non-independent director's membership on a committee is required by the best interests of the company and its stockholders.

Comments should be submitted to Nasdaq within 45 days of the publication of notice in the *Federal Register*. For more information, click here.

BROKER DEALER

FINRA Provides Additional Guidance on New Suitability Rule

In November 2010, the Securities and Exchange Commission approved FINRA's new suitability rule — FINRA Rule 2111 (the Rule). Previously, FINRA issued Regulatory Notices 11-02 and 11-25 discussing the Rule's requirements, offering further guidance on the Rule and announcing a new implementation date of July 9, 2012.

In response to industry questions, FINRA has released a third notice, Regulatory Notice 12-25, in order to provide additional guidance on the Rule. Regulatory Notice 12-25 addresses questions that are representative of the issues firms are attempting to resolve as they finalize their plans for compliance with the Rule. Nevertheless, FINRA has emphasized that it previously addressed numerous issues and it encourages firm's to review (1) FINRA's responses to comments submitted during the rulemaking process and (2) Regulatory Notices 11-02 and 11-25.

Click here for FINRA Regulatory Notice 12-25.

CFTC

CFTC Roundtable to Discuss Proposed Regulations Implementing Core Principle 9 for Designated Contract Markets

The staff of the Commodity Futures Trading Commission will hold a public roundtable on Tuesday, June 5, to discuss the proposed regulations implementing Core Principle 9 for designated contract markets. Core Principle 9 requires designated contract markets to provide competitive, open and efficient markets. The roundtable is set to discuss: (1) centralized market trading requirements; (2) certain aspects of the requirements for exchange of derivatives for related position transactions; and (3) reporting timeframe for block transactions in futures contracts.

The CFTC press release containing further information regarding the roundtable is available here.

LITIGATION

Bankruptcy Court Determines that Property Transfer by Corporation in Which Debtor Holds a 50% Interest Does Not Constitute a Transfer of Assets of the Bankruptcy Estate

The United States Bankruptcy Court for the District of New Jersey recently found that a debtor's transfer of property owned by a corporation in which the debtor allegedly held a 50% interest did not automatically constitute a transfer of assets of the debtor's bankruptcy estate. After the debtor filed a voluntary Chapter 7 bankruptcy petition, the Chapter 7 trustee filed an adversary complaint alleging that the debtor purposefully had executed a post-petition mortgage lien on certain real property owned by a corporation of which the debtor was a 50% owner. Based on the debtor's alleged ownership interest, the trustee argued that the debtor's transfer of assets owned by the corporation was tantamount to a transfer of assets belonging to the bankruptcy estate. The Bankruptcy Court disagreed and found that the debtor and the corporation in which the debtor allegedly held a 50% interest were separate legal entities. As such, the Court held that the assets of the corporation did not automatically become assets of the debtor's bankruptcy estate. The Bankruptcy Court further found that the trustee had failed to meet its burden of demonstrating such unity of interest and ownership between the debtor and the corporation that would allow the trustee to pierce the corporate veil.

In re Nicholas and Marcy Braco, Bankruptcy No. 11-18798 (MBK) (Bankr. D.N.J. May 25, 2012).

Ninth Circuit Affirms Dismissal of Securities Fraud Complaint

The U.S. Court of Appeals for the Ninth Circuit recently affirmed a California district court's ruling that plaintiffs failed to adequately plead misrepresentation and scienter in support of their claims for violation of Section 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5. Specifically, the Ninth Circuit found that the complaint failed to allege a material omission where there was no allegation that the inclusion of further information regarding a cross-collateralization agreement would have revealed any specific problems with other properties at the time the Private Placement Memorandum (PPM) was issued. The Ninth Circuit also affirmed the district court's dismissal of plaintiffs' Securities Act of 1933 claims, finding that plaintiffs had waived any challenge to the dismissal of these claims by failing to challenge the district court's finding that the PPM did not qualify as a prospectus.

Scarborough v. Berthel Fisher & Company Fin. Servs., Inc., No. 11-55313 (9th Cir. May 24, 2012).

BANKING

Federal Reserve to Meet on Regulatory Capital Framework

On May 31, the Federal Reserve Board announced it will hold a public meeting on June 7 at 3:30 p.m. to discuss proposed interagency rulemakings on strengthening and harmonizing the regulatory capital framework for banking organizations, including proposed rules for implementing Basel III for banking organizations and proposed

consolidated capital requirements for savings and loan holding companies. The agency will also discuss final interagency rulemaking on market risk capital rule.

Attendees must register by June 6. For more information, click here.

Fed Approves Final Rule for Registering Securities Holding Companies

On May 30, the Federal Reserve Board approved a final rule outlining the procedures for securities holding companies (SHCs) to elect to be supervised by the Federal Reserve. An SHC is a nonbank company that owns at least one registered broker or dealer. In effect, the rule provides a way for U.S.-based companies to show foreign regulators that the firm is indeed a regulated entity in the U.S.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) eliminated the previous supervision framework that applied to SHCs under the Securities and Exchange Commission and permitted SHCs to be supervised by the Federal Reserve. An SHC may seek supervision by the Federal Reserve to meet requirements by a regulator in another country that the firm be subject to comprehensive, consolidated supervision in the United States in order to operate in the country.

The final rule specifies the information that an SHC will need to provide to the Federal Reserve as part of registration for supervision, including information related to organizational structure, capital, and financial condition. Under the final rule, an SHC's registration becomes effective no later than 45 days from the date the Federal Reserve receives all required information.

The final rule provides that upon an effective registration, an SHC would be supervised and regulated as if it were a bank holding company. However, consistent with the Dodd-Frank Act, the restrictions on nonbanking activities in the Bank Holding Company Act would not apply to a supervised SHC.

For more information, click here.

UK DEVELOPMENTS

FSA Restricts Payments for Order Flow

The UK Financial Services Authority (FSA) has recently issued guidance restricting the use of payment for order flow (PFOF) arrangements (the Guidance). PFOF for this purpose refers to arrangements under which brokers receive payment from market makers in exchange for sending orders to them.

The FSA states in the Guidance that it considers that in principle PFOF arrangements create a clear conflict of interest between brokers and their clients. Brokers have an incentive to direct order flow to market makers offering PFOF, potentially compromising clients' best interests. PFOF payments from a market maker to a broker are permissible only where the relevant FSA rules on best execution, inducements and conflicts of interest are satisfied. Brokers receiving PFOF will need to demonstrate that they have implemented and maintain effective conflicts of interest management policies, procedures and organizational arrangements designed to avoid any disadvantage to clients.

Further, in order to be permissible under the FSA's rules on inducements, PFOF payments must satisfy all three of the following tests:

- Test 1: The PFOF payment must "not impair the compliance with the firm's duty to act in the best interests of the client;"
- Test 2: Details of PFOF payments must be disclosed to clients "in a manner that is comprehensive, accurate and understandable, before the provision of the service;" and
- Test 3: The PFOF payment must be "designed to enhance the quality of the service to the client."

To satisfy Test 1, the broker will need to demonstrate that it has obtained the best possible price by complying with applicable best execution obligations. In order to do so it will need to compare PFOF market maker prices with prices from market makers that do not pay for order flow.

Test 2 requires the broker to disclose details of the payment ahead of the provision of the relevant services. The disclosure will need to specify the amount of the payment and to be given to the client before execution of any transaction. If the amount of the payment changes, such change will need to be communicated to the client before any further transactions are executed for that client.

To satisfy Test 3, the broker will need to provide a justification as to how the relevant payment is designed to enhance the quality of service to the client. In making this assessment the broker must also consider the nature and extent of the benefit (and any expected benefit) to the broker. It will be challenging to satisfy Test 3, since the FSA states in the Guidance that: "It is difficult to see how a firm could provide any justification that PFOF benefits the client directly. There are no obvious benefits save the one that the firm receives more remuneration from the provision of the execution services. However, this may be at the expense of the client so that in effect this may amount to no more than simply charging the client additional fees."

The Guidance notes that in the inter-dealer broker market (which is predominantly OTC), where neither party relies on the broker or has the expectation that the broker will be acting on its behalf, the broker charges both parties a commission. This payment arrangement will not amount to payment for order flow.

The Guidance also states that the FSA's specific concerns are unlikely to apply to liquidity incentive schemes operated by trading venues.

For more information, click here.

FSA Bans Former Hedge Fund CEO Alberto Micalizzi and Imposes £3 Million Fine

On May 29, the UK Financial Services Authority (FSA) announced that it had decided to fine Alberto Micalizzi £3 million (approximately $4.6 million) and ban him from performing any role in regulated financial services for not being fit and proper. This is the largest fine imposed by the FSA on any individual in any case other than a market abuse case. Micalizzi was the chief executive officer and a director of Dynamic Decisions Capital Management Ltd (DDCM), a hedge fund manager. The FSA also announced that it had cancelled DDCM's permission to carry on regulated business. The FSA's decisions have been appealed to the Upper Tribunal.

According to the FSA Decision Notices, between October 1, 2008 and December 31, 2008, the master fund managed by DDCM (the Fund) lost approximately 85% of its value. The FSA found that to conceal the losses, Micalizzi lied to investors about the true position of the Fund and, in late 2008, entered into a number of contracts, on behalf of the Fund, for the purchase and resale of a bond (the Bond Contracts). The FSA considered that the bond was not a genuine financial instrument and that Micalizzi was aware of this when he entered into the Bond Contracts which accordingly were deliberately undertaken by Micalizzi to create artificial gains for the Fund. (Units of the bond were sold to the Fund at a deep discount to their face value, and then valued by the Fund at approximately their face value when reporting to investors.) The Fund was placed into liquidation in May 2009.

The FSA also found that during the course of its investigation Micalizzi repeatedly provided it with false and misleading information.

The FSA found Micalizzi to have breached Principle 1 of its Statement of Principles and Code of Conduct for Approved Persons (APER) under which approved persons are required to act with integrity.

The FSA cancelled the permission of DDCM to conduct regulated business for (1) failing to satisfy the threshold conditions under the Financial Services and Markets Act 2000 and the rules of the FSA with respect to such permission; (2) not being fit and proper as it had failed to ensure that its business was conducted soundly and prudently and in compliance with proper standards in breach of Threshold Condition 5 (suitability).

In November 2011 in a related case (as reported in the December 9, 2011 edition of *Corporate and Financial Digest*) the FSA banned and fined the compliance officer of DDCM.

Tracey McDermott, the FSA's acting director of enforcement and financial crime, said: "Alberto Micalizzi's conduct fell woefully short of the standards that investors should expect and behaviour like his has no place in the financial services industry and we are committed to tackling it wherever we find it."

For more information regarding Micalizzi, click here. For more information regarding DDCM, click here.

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