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SEC/Corporate

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SEC's Director of the Division of Corporation Finance Looks to International Financial Reporting Standards for U.S. Companies

Last week, John W. White, Director of the Division of Corporation Finance of the Securities and Exchange Commission, gave a speech at the Global Financial Reporting Convergence Conference in which he frankly discussed developments over the past year leading to growing acceptance of International Financial Reporting Standards (IFRS) in global markets and in the United States.

In July 2007, the SEC voted to eliminate the U.S. GAAP reconciliation requirement for foreign private issuers that file their financial statements with the SEC using IFRS as issued by the International Accounting Standards Board (IASB), after recognizing the high quality and globally accepted accounting principles embodied in IFRS and coming to the conclusion that the reconciliation requirement was no longer necessary when the financial statements are prepared in accordance with these standards.

Following closely on the action with respect to foreign private issuers, in August 2007, the SEC published a concept release asking a series of questions on whether U.S. issuers should be allowed to choose, or should be required, to prepare financial statements under IFRS as issued by the IASB. The SEC has received more than 80 comments on the release. Subsequently, in December 2007, the Commission held two roundtables on the topic of U.S. issuers using IFRS. Early this year, SEC Chairman Cox charged staff members in the Division of Corporation Finance and the Office of the Chief Accountant with developing a roadmap for the SEC's consideration that according to Mr. White, "would formally propose a schedule and appropriate milestones for continuing the progress that the U.S. is making to more fully accept IFRS in this country, not just from foreign companies but also from U.S. companies."

Notwithstanding the success of U.S. GAAP in serving U.S. capital markets, Mr. White noted the compelling arguments in favor of the movement to the acceptance of IFRS as the global standard. The development of a single set of accounting standards would provide significant benefits to all stakeholders in the global capital markets, including those in the U.S. IFRS has become the global standard. After the EU adopted IFRS in 2002, many countries have followed suit and more than 100 countries, including Australia, Canada, Israel and the EU, now require or permit the use of IFRS. According to Mr. White, "it is an 'inconvenient truth' that the world is not looking to U.S. GAAP as the global standard." U.S. adoption of IFRS would be critical in enabling the U.S. to maintain a persuasive position in the standard setting process for IFRS.

Despite the benefits of U.S. adoption of IFRS, it is clear that the SEC is taking diligent steps to ensure that the judgments it makes are most appropriate for the U.S. marketplace, and in that regard Mr. White poses the following questions for consideration:

- Should all U.S. companies simply be mandated to start using IFRS in their filings as of a certain date?
- Should there first be a period in which U.S. companies have the option to use IFRS in their financial statements, and if so, how long should such a period be?
- If there were such a period of optional use, would U.S. companies feel inclined to change to the IFRS unless it were clear that the mandated use of IFRS were in the foreseeable future?

If there was any doubt before, in closing, Mr. White said: "I truly believe that the endpoint will be U.S. issuers using IFRS and that it is time to move in this direction. The SEC can provide leadership by planning now for how that result might be brought about."

http://www.knowledgemosaic.com/net/public/smdocumenthead.aspx?FilePath=rules/SP.spch060508jww.060508.htm&Title=IFRS+and+U%2ES%2E+Companies%3A+A+Look+Ahead&EmailSubject=IFRS+and+U%2ES%2E+Companies%3A+A+Look+Ahead&ShowSMHeader=1&IsBack=0&BreadCrumbText=News+%3E

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Investors Adequately Plead a Claim of Securities Fraud

The Ninth Circuit has found that the district court improperly dismissed a securities fraud class action filed by investors against a telecommunications company and its officers. Plaintiffs alleged that the company, which provided customized signal processing systems to federal agencies, violated Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 by misleadingly reporting that contracted work for which the government had issued "stop-work" orders was "backlog." Plaintiffs alleged that because payments would cease when the government issued a "stop-work" order, and because stopped work is often eventually cancelled, the company's backlog reports misled them to believe that the company would perform work that had been halted and likely lost forever.

In reversing the lower court's dismissal of the complaint, the Ninth Circuit held that plaintiffs pleaded with sufficient particularity the existence, content and effect of the "stop-work" orders by identifying four confidential witnesses who worked for the company and would testify to the existence and effect of the "stop-work" orders. The Court also rejected defendants' argument that reasonable investors would have understood that the defendants were counting stopped work as backlog because the company stated in its filings with the Securities and Exchange Commission that its backlog consisted "of anticipated revenues from the uncompleted portions of existing contracts." The Court also determined that plaintiffs adequately pled scienter of the company's CEO and CFO because, even though the complaint did not allege particular facts that they knew about the "stop-work" orders, the officers were the company's top managers and thus it could be inferred that they knew about the orders. (*Berson v. Applied Signal Technology, Inc.*, 2008 WL 2278670 (9th Cir. June 5, 2008))

"Obey the Law" Injunction Entered Against Broker

After a jury found that a broker had violated Section 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and Section 17(a) of the Securities Act of 1933, the Securities and Exchange Commission sought an order permanently enjoining the broker from violating, or aiding and abetting violations of, various securities statutes. The broker argued that such "obey the law" injunctions were unlawful, relying on *SEC v. Smyth*, in which the Eleventh Circuit in 2005 stated that orders enjoining future violations of the securities laws were unenforceable. The Court rejected the broker's arguments, held that the *Smyth* language on which the broker relied was *dicta*, and found that such injunctions were permissible in the Eleventh Circuit and elsewhere. The Court further found that the injunction was not overly broad or vague. Noting that there was a reasonable likelihood that the broker would commit future violations of securities laws, the Court granted the injunction. (*SEC v. Solow*, 2008 WL 2127450 (S.D. Fla. May 14, 2008))

Broker Dealer

CBOE Proposes Rules Related to Sponsored Users

The Chicago Board Options Exchange proposed rules that would allow "Sponsored Users" to access all products traded on CBOE. Currently, Sponsored Users, i.e., non-CBOE member firms that have entered into a sponsorship arrangement with a CBOE member for purposes of receiving direct electronic access to CBOE, are only allowed access to CBOE's FLEX Hybrid Trading System (FLEX) and the CBOE Stock Exchange (CBSX) facility. Although the rule proposal would not change the requirements currently applicable to sponsored access to FLEX and CBSX, it would limit the number of Sponsored Users with access to all CBOE products to a total of 15 persons or entities. These "Sponsored User Slots" would be allotted on a first-come, first-served basis.

http://www.sec.gov/rules/sro/cboe/2008/34-57836.pdf

ISE Amends PIM Rules

The Securities and Exchange Commission approved a proposed rule change submitted by the International Securities Exchange (ISE) that will allow members to enter orders into the Price Improvement Mechanism (PIM) at a price that matches the national best bid or offer (NBBO) when the ISE market is inferior to the NBBO. The PIM currently allows certain ISE members to enter two-sided orders for execution at a price that improves upon the NBBO. The rule change will extend the application of the PIM to permit a member to enter an order into the PIM at a price that is equal to the NBBO when the ISE's best bid or offer is inferior to the NBBO. The SEC believes the amended rule will continue to provide customers with an opportunity for price improvement over the NBBO. Furthermore, the amended rule should encourage increased participation in a PIM by ISE members willing to trade with an agency order at, but not better than, the NBBO.

http://www.sec.gov/rules/sro/ise/2008/34-57847.pdf

CBOE Proposes Rule Changes to Reduce Order Handling and Exposure Periods to One Second

The Chicago Board Options Exchange has filed with the Securities and Exchange Commission a proposed rule change to reduce the order handling and exposure periods contained in certain CBOE rules from three seconds to one second. The proposal is aimed at affecting CBOE Rules 6.45A (Priority and Allocation of Equity Option Trades on the CBOE Hybrid System), 6.45B

BROKER DEALER

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(Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System), 6.74A (Automated Improvement Mechanism) and 6.74B (Solicitation Auction Mechanism).

For instance, Rules 6.45A and 6.45B provide that an order entry firm may not execute an order it represents as agent with a facilitation or solicited order using the Hybrid Trading System unless it first complies with the three-second exposure requirement. Under the proposal, the three-second exposure requirement would be reduced to one second. Rules 6.74A and 6.74B would be similarly affected. CBOE believes it would be in all market participants' best interest to minimize the exposure period while also allowing for sufficient time to ensure effective interaction with orders. The reduction in time period will provide investors and other market participants with more timely executions, thereby reducing market risk. Most importantly, CBOE believes the one-second exposure period will provide market participants with sufficient time to respond, compete and provide price improvements for orders.

http://investor.gov/rules/sro/cboe/2008/34-57849.pdf

CFTC

CFTC to Form Interagency Task Force on Commodity Markets

The Commodity Futures Trading Commission has announced the formation of a new task force composed of representatives from the CFTC, the Federal Reserve, the Securities and Exchange Commission and the Treasury, Energy and Agriculture Departments. The interagency task force will evaluate recent price increases and other developments in commodity markets, including an examination of investor practices, supply and demand factors, and the role of speculators and index traders in these markets, and will publish its findings.

http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5508-08.html

CFTC's Energy Markets Advisory Committee Holds First Meeting

The Commodity Futures Trading Commission's Energy Markets Advisory Committee (EMAC) held its first meeting on June 10. The EMAC was created as part of the CFTC's broader effort to enhance transparency and oversight with respect to energy markets and includes representatives from various energy industry participants. At the meeting, the CFTC's Division of Market Oversight presented an update on energy markets and discussed the CFTC's recently announced energy market initiatives, including its ongoing national crude oil investigation and its plans to enhance monitoring of index trading activity in the energy markets.

http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5507-08.html

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Banking

Fed Approves Bank of America to Acquire Countrywide

The Board of Governors of the Federal Reserve System (the Board) approved on June 5 the acquisition of Countrywide Financial Corporation (CFC), parent of Countrywide Bank, FSB, by Bank of America Corporation (BAC). As structured, CFC will merge with and into a subsidiary of BAC, and CFC will be come a subsidiary of BAC. The approval also covered BAC's proposal to acquire indirectly certain other nonbanking subsidiaries of CFC. The Board concluded, in its 32 page order, that "although Bank of America would become the largest mortgage loan servicer in the United States on consummation of the proposal, the mortgage servicing market would remain unconcentrated." The Board also stated that a Department of Justice investigation had

BANKING

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concluded that the merger would "not likely have a significant adverse effect on competition in any relevant banking market."

http://www.federalreserve.gov/newsevents/press/orders/orders20080605a1.pdf

UK Developments

UK Super-Equivalent Market Abuse Clauses to be Retained

On June 6, the UK Treasury published comments from its consultation regarding the provisions of the UK's market abuse regime which are "super-equivalent" to the regime under the EU Market Abuse Directive. The consultation was conducted between February and May, 2008, as reported in the February 8, 2008 edition of *Corporate and Financial Weekly Digest*.

The key super-equivalent provisions of the UK regime are section 118(4) (misuse of information) and section 118(8) (behavior likely to give rise to false or misleading impressions or to distort the market) of the Financial Services and Markets Act 2000. These so-called "sunset" or limited lifespan provisions would have automatically expired June 30, 2008, unless extended.

Following the Treasury's consultation, it is now proposed to extend the super-equivalent provisions until December 31, 2009.

www.hm-treasury.gov.uk./media/8/C/consult_fsma_marketabuse_responses060608.pdf

UK Financial Services Authority Introduces Disclosure Regime for Significant Short Positions in Companies Undertaking Rights Issues

This morning the UK Financial Services Authority (FSA) announced that with effect from June 20, it "will require the disclosure of significant short positions in stocks admitted to trading on prescribed markets which are undertaking rights issues."

These new disclosure requirements, which have been inserted into the FSA's Code of Market Conduct, require the disclosure of short positions of 0.25% or more of the issued shares of a relevant issuer achieved via short selling or by any instruments giving rise to an equivalent economic interest**,** such as contracts for differences, swaps or options.

Failure to give the required disclosure will constitute market abuse under the FSA's Code of Market Conduct which applies to all market participants, not just to FSA regulated firms.

The FSA also stated that it is considering the possibility of introducing further measures including: restricting lending securities the subject of rights issues for the purposes of enabling short selling, and restricting short sellers from covering their positions by acquiring the rights to the newly issued shares.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2008/057.shtml
http://www.fsa.gov.uk/pubs/press/PN0572008_instrument.pdf

UK DEVELOPMENTS

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