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CORPORATE & FINANCIAL

WEEKLY DIGEST

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SEC/CORPORATE

Senate Bill Proposes SEC Whistleblower Law

Among the myriad provisions of the pending financial reform bill is the creation of a viable whistleblower system under which informants who report securities laws violations to the Securities and Exchange Commission will be provided with monetary rewards. The plan is based in part on the success of the Internal Revenue Service's similar whistleblower program.

Under proposed Section 922 of the Restoring American Financial Stability Act of 2010 (the Senate Bill), the SEC will be required to pay a reward to individuals who provide "original information" to the SEC that results in monetary sanctions to the violating party exceeding $1 million. The award can range from 10% to 30% of the amount that is recouped, with the actual amount of the award at the discretion of the SEC. Section 922 prohibits the SEC from providing an award to a whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower provided information; who gains the information from a government investigation, report or audit; who fails to submit information to the SEC as required by an SEC rule; or who is an employee of the U.S. Department of Justice or a regulatory agency, a self-regulatory organization, the Public Company Accounting Oversight Board or a law enforcement organization.

The Senate Bill would explicitly provide for whistleblower retaliation protection, so as to prevent employers from firing or otherwise discriminating against those taking advantage of this law. Section 922 creates a prohibition against retaliation and a private right of action for employees who have suffered retaliation.

Section 922 of the Senate Bill closely resembles Section 7203 of the House of Representatives' earlier Wall Street Reform and Consumer Protection Act of 2009, H.R. 4173 (the House Bill). The key difference, however, is that the Senate Bill provides for a 10% floor on whistleblowing awards, while the House Bill provides for no floor.

Reconciliation of the House and Senate Bills is underway, with debate on these sections scheduled for next week.

The Senate Bill can be accessed here.
HR 4173 can be accessed here.

BROKER DEALER

SEC Approves Amendments Regarding Reporting Transactions to the OTC Reporting Facility

The Securities and Exchange Commission has approved amendments relating to the reporting of over-the-counter (OTC) transactions in non-National-Market-System stocks to the OTC Reporting Facility (ORF). Effective November 1, firms must comply with amended rules on applicable trade report modifiers when reporting such transactions. Among other things, the amendments reorganize the format and structure of Financial Industry Regulatory Authority Rule 6622(a) so that it conforms generally to the trade reporting rules of the Alternative

Display Facility and Trade Reporting Facilities. Although not yet required under current FINRA Rule 6622(a), firms are already permitted to use certain of the amended trade report modifiers when reporting to the ORF.

Click here to read FINRA Regulatory Notice 10-29.

SEC Approves Amendments Permitting FINRA Trading-Pause Pilot Program

On June 10, the Financial Industry Regulatory Authority began a pilot program in which it will halt trading otherwise than on an exchange with respect to securities included in the S&P 500 Index where the primary listing market has issued a trading pause due to extraordinary market volatility. The pilot program is part of a coordinated effort among FINRA, the Securities and Exchange Commission and other self-regulatory organizations to provide for a coordinated means to address potentially destabilizing market volatility and will end on December 10, 2010. FINRA said that it anticipates these trading-pause rules will soon be expanded to include additional securities, such as exchange-traded funds, within the pilot period.

Click here to read FINRA Regulatory Notice 10-30.

CFTC

CFTC, SEC to Hold Joint Advisory Committee Meeting to Discuss Emerging Regulatory Issues

The Commodity Futures Trading Commission and the Securities and Exchange Commission will hold a joint advisory meeting to discuss emerging regulatory issues. The meeting is open to the public and will be held at 1 p.m. (EDT) on Tuesday, June 22, in the Auditorium, Room L-002, at the SEC's Washington, D.C., offices at 100 F Street, NE. Representatives from various exchanges and firms will testify on the market events of May 6.

Notice of the meeting can be found here.

Chicago Mercantile Exchange Implementing Cleared OTC Derivatives Segregation Requirement

The Chicago Mercantile Exchange (CME) has announced new rules that, subject to the CME Clearing House Risk Committee and other approvals, would require customer "cleared over-the-counter (OTC) derivatives" to be held in a separate account. The CME rules implement recent amendments to the Commodity Futures Trading Commission's Bankruptcy Rules, Part 190, creating a new, separate customer account class for "cleared OTC derivatives." When the new rules become effective, existing customer positions in cleared OTC derivatives, currently held in CFTC Rule 30.7 secured amount accounts, will be required to be transferred to separate cleared OTC derivative customer accounts. Clearing futures commission merchants (FCMs) will be required to maintain funds for all amounts owed to cleared OTC customers in cleared OTC customer accounts and to prepare daily statements for cleared OTC customers. Clearing FCMs will be required to compute their cleared OTC customer requirement, the funds held in cleared OTC customer accounts and any excess (or deficiency) of funds in cleared OTC customer accounts. The rules will also require clearing FCMs to call for and collect performance bond collateral for positions in cleared OTC derivatives. FCMs will also be required to open new bank and safekeeping accounts for cleared OTC customer assets.

The CME plans to provide clearing firms with testing opportunities for the new cleared OTC derivatives account class in late July. The rules are expected to become effective on September 13.

The CME Advisory Notice can be found here.

CFTC Denies Options Clearing Corporation Rule Amendment

The Commodity Futures Trading Commission has declined to approve a proposed rule amendment by the Options Clearing Corporation (OCC) that would have classified certain foreign currency exchange contracts with a nominal exercise price such as $0.01 as securities options. OCC contended in the submission that, other than the low strike price, the products were essentially the same as the cash-settled, foreign currency options currently cleared by OCC and, therefore, these products should be subject to the exclusive jurisdiction of the Securities and Exchange Commission, be traded on national securities exchanges and treated and cleared as securities options.

The CFTC rejected this analysis, however, and noted that, because the nominal strike price resulted in the products being deep in the money from inception, the option premium would be economically indistinguishable from the value of a futures contract on the underlying asset. The CFTC concluded that products are not bona fide options and therefore are subject to the Commodity Exchange Act and must be traded exclusively on a designated contract market or a derivatives transaction execution facility.

The denial notice from the CFTC can be found here.

CFTC Requests Comment on Exemptive Relief Request for Foreign Stock Index Futures

The Commodity Futures Trading Commission has requested public comment on a petition for exemptive relief filed by Hard Eight Futures, LLC, a registered commodity trading advisor, pursuant to Section 4(c) of the Commodity Exchange Act (CEA). The requested relief would permit persons qualifying as "eligible contract participants" (ECPs), as defined in Section 1a(12) of the CEA, to trade foreign-listed security index futures contracts on broad-based indices without a prior grant of no-action relief to the listing exchange. Currently, such contracts may only be offered and sold to U.S. persons (including ECPs) after the listing exchange has received no-action relief.

The relief requested in the petition would be limited to indices of which the underlying securities are principally traded on, by or through a non-U.S. market, and would be further conditioned upon the existence of a Memorandum of Understanding between the CFTC and the regulator of the listing exchange. If the petition were granted in its current form, ECPs seeking to rely upon this relief would be required to file a notice containing certain specified information regarding such ECP and the relevant contract to be traded with the CFTC, and the exemption would then take effect 10 business days thereafter (absent CFTC objection).

In its request for comment, the CFTC has raised several questions regarding the petition, including whether additional conditions should be imposed upon the requested relief. Comments must be submitted by July 19.

The CFTC's request for comment is available here.

CFTC Grants Exemption and Approves Rule Changes for Gold and Silver ETF Contracts

The Commodity Futures Trading Commission has issued an exemption, pursuant to Section 4(c) of the Commodity Exchange Act (CEA), which would permit options and futures on ETFs Physical Swiss Gold Shares and ETFs Physical Swiss Silver Shares to be traded and cleared, in the case of options contracts, as options on securities, and in the case of futures contracts, as security futures contracts. The exemption is consistent with prior CFTC action on similar exchange-traded fund products, which have gold and silver, both regulated commodities, as their primary underlying assets, and thus implicate potentially overlapping areas of authority between the CFTC and the Securities and Exchange Commission. In conjunction with the exemption, the CFTC also approved a requested change to the rules of the Options Clearing Corporation (OCC) to permit the OCC to clear these products.

The CFTC press release regarding the exemption and rule change is available here.

LITIGATION

SEC Can Seek Bonuses of "Innocent" CEOs

The Securities and Exchange Commission does not have to allege that the chief executive officer (CEO) or the chief financial officer (CFO) of a public company engaged in malfeasance in order for the agency to seek reimbursement to the issuer of bonuses paid to the CEO if wrongful conduct results in a restatement, an Arizona federal court ruled.

The SEC has requested a court order that would direct Maynard Jenkins, former CEO of CSK Auto Corp., to pay back about $4 million in bonuses he received when CSK's earnings were inflated because of a purported fraud at CSK. Although there were no indications that Mr. Jenkins knew about the fraud, the SEC argued that he was still subject to the reimbursement provisions of Section 304 of the Sarbanes Oxley Act of 2002 (SOX), which provide that CEOs and CFOs must reimburse incentive pay to the issuer if a company restates its earnings because of "material noncompliance of the issuer, as a result of misconduct."

Jenkins sought dismissal of the SEC request, contending that company officials are only subject to SOX clawback provisions if they personally engaged in wrongdoing. The U.S. District Court for the District of Arizona disagreed, holding that the plain text of the statute showed that Congress wanted to recover bonuses based on a company's noncompliance with SOX standards, rather than on the wrongdoing of individual officers. However, the District Court narrowed its holding to the pleadings stage of litigation, explaining that defendants may be able to demonstrate that the application of the SOX clawback provisions would be overly punitive in particular circumstances and thus would run afoul of constitutional requirements. (*S.E.C. v. Jenkins*, 2010 WL 2347020 (D. Ariz. June 9, 2010))

Terms of Expired Agreement Not Extended by Negotiations

Negotiations over the renewal of an expired contract did not extend the terms of the business relationship between the negotiating parties, a Pennsylvania federal court ruled, thus a "limitation of suit" provision in the expired agreement foreclosed the plaintiff's contract claims.

Storyville Enterprises in 1996 executed a 10-year franchise agreement with tobacco retailer Tinder Box Intl., Ltd., which required either party to bring a claim "arising out of or under [the] agreement" within one year of its accrual. The contract lapsed in October 2006, but neither party was aware of the expiration until four months later. After negotiations to extend the contract faltered, Tinder Box sued Storyville in November 2007 for breach of contract and other tort claims in U.S. District Court for the Eastern District of Pennsylvania.

Tinder Box argued that its contract claims were timely because post-expiration negotiations had prolonged the terms of the franchise agreement, based on the general principle that the provisions of an expired contract will govern the business relations between two parties if such relations continue. The District Court held that this principle did not apply because the terms of the contract clearly showed that the parties intended for the agreement to last 10 years and for it only to be altered in writing. Accordingly, all claims predicated on the contract were barred by the limitations provision. (*Tinder Box Intern., Ltd. v. Patterson*, 2010 WL 2302298 (June 7, 2010))

BANKING

Banking Agencies Propose to Expand Scope of Community Reinvestment Act Regulations

On June 17, the four federal bank and thrift regulatory agencies announced a proposed change to the Community Reinvestment Act (CRA) regulations to support stabilization of communities affected by high foreclosure levels. The proposed change specifically would encourage depository institutions to support the Neighborhood Stabilization Program (NSP) administered by the U.S. Department of Housing and Urban Development (HUD). Specifically, the agencies propose to revise the term "community development" to include loans, investments and services by financial institutions that support, enable or facilitate projects or activities that meet the criteria described in Section 2301(c)(3) of the Housing and Economic Recovery Act of 2008 (HERA) and are conducted in designated target areas identified in plans approved by HUD under the NSP, established pursuant to the HERA and the American Recovery and Reinvestment Act of 2009. The proposed rule would provide favorable CRA consideration to such activities that, pursuant to the requirements of the program, benefit low-, moderate-, and middle-income individuals and geographies in designated target areas.

Under the NSP, HUD has provided funds to state and local governments and nonprofit organizations for the purchase and redevelopment of abandoned and foreclosed properties. The agencies' proposal would encourage depository institutions to make loans and investments and provide services to support NSP activities in areas with HUD-approved plans. The proposal would supplement existing CRA consideration for community development activities, including neighborhood stabilization activities. For example, for NSP areas identified in HUD-approved plans, the agencies would provide CRA consideration for activities that benefit individuals with incomes of up to 120% of the area median and geographies with median incomes of up to 120% of the area median. NSP-eligible activities would receive favorable consideration under the new rule only if conducted within two years after the date when NSP program funds are required to be spent.

Comments on the proposed rule must be submitted no later than 30 days from the date of its publication in the *Federal Register*, which is expected shortly.

Separately, the agencies also announced today they will hold four hearings to consider public comment on all aspects of the CRA regulations during the summer of 2010.

Read more.

EXECUTIVE COMPENSATION AND ERISA

Please see "Senate Bill Proposes SEC Whistleblower Law" in **SEC/Corporate** above.

UK DEVELOPMENTS

UK Government Announces Transfer of FSA Powers to Bank of England and New Regulators

In a speech delivered on June 16, the Chancellor of the Exchequer announced that the UK Government intended to transfer the regulatory functions of the UK Financial Services Authority (FSA) to the Bank of England and certain proposed new regulatory bodies. The FSA will cease to exist in its current form. In its place, the government intends to establish the following new entities between now and the end of 2012:

- Prudential Regulation Authority (PRA)—The PRA, which will be a subsidiary of the Bank of England, will be responsible for the prudential regulation of financial firms, including banks, investment banks, building societies and insurance companies. Hector Sants, the current FSA Chief Executive, will become the PRA chief executive and also a deputy governor of the Bank of England.
- Consumer Protection and Markets Authority (CPMA)—The CPMA will regulate firms providing financial services to consumers. It will also be responsible for retail and wholesale financial services conduct of business.
- Financial Policy Committee (FPC)—The FPC will be a committee of the Bank of England. It will have responsibility for macro issues potentially affecting economic and financial stability. An interim FPC will be established during the course of 2010. The Governor of the Bank of England will chair the FPC, and its members will include the PRA chief executive and the CPMA chair.
- Economic Crime Agency (ECA)—The ECA will be created to prosecute economic and financial crimes. This is currently in the hands of a number of agencies, including the FSA, the Serious Fraud Office, the Office of Fair Trading and the Serious Organised Crime Agency.

A consultation document providing details of the Government's proposals will be issued shortly.

Read more.

EU DEVELOPMENTS

EU Consults on Derivatives and Market Infrastructures

On June 14, the European Commission published a consultation on Derivatives and Market Infrastructures. This follows on from its October communication on future policy actions to ensure efficient, safe and sound derivatives markets (as reported in the October 23, 2009, edition of *Corporate and Financial Weekly Digest*).

The consultation addresses a number of topics, including: clearing and risk mitigation of over-the-counter derivatives contracts; requirements for central counterparties (CCPs); interoperability between CCPs; and reporting obligations and requirements for trade repositories.

The consultation closes on July 10, 2010. The Commission will then prepare a formal legislative proposal, currently scheduled to be published in September.

Read more.

EU Consults on Short Selling

On June 14, the European Commission published a consultation on short selling, which sets out options being considered by the Commission for a pan-European regime for the regulation of short selling.

The consultation focuses on five key areas: scope; transparency; risks of uncovered short sales; emergency powers for national regulatory authorities; and potential exemptions.

The consultation closes on July 10, 2010. The Commission will then prepare a formal legislative proposal, currently scheduled to be published in September.

Read more.

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