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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Proposes Easing Foreign-Company Accounting Rules

On June 20, the Securities and Exchange Commission approved a proposal to eliminate the requirement that foreign private issuers reconcile their financial results with United States generally accepted accounting principles, commonly referred to as GAAP. The SEC regulation would apply only to companies using rules approved by the London-based International Accounting Standards Board, which sets international accounting standards. The European Union Financial Services Commissioner, Charles McCreevy, has pledged to recognize United States accounting rules by 2009.

SEC Chairman Christopher Cox stated that the rule change would be a "significant next step on the road toward a single set of globally accepted standards," which is in accord with one of the SEC's "overarching" focuses as capital increasingly flows to exchanges in Europe and Asia. Others have commented that allowing foreign companies to use international accounting rules will encourage firms to sell shares in the United States by reducing expenses. The international standards are deemed especially desirable for large United States companies with foreign subsidiaries which now must maintain two different sets of books. Some analysts have warned that eliminating the requirement and perhaps giving all companies their choice of accounting systems would make it more difficult for investors to evaluate and compare financial results of different companies.

If approved, after a 75-day public comment period, such change would apply to 2008 annual reports which are submitted in early 2009.

http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a6yclmDbVi0Q

SEC Adopts Changes to Proxy Rules

The Securities and Exchange Commission on June 20 adopted rule changes that would allow shareholders to choose between receiving annual proxy materials from issuers on paper or electronically beginning in 2008. Issuers would be permitted to send proxy materials in paper form to shareholders if they also post the information on their internet website. While earlier this year, the SEC adopted rules (which are effective on July 1) permitting a company to choose the method of distributing proxy materials, the new rules, in effect, will require companies to give shareholders (and soliciting persons) the choice between electronic and paper receipt of proxy materials, effective January 1, 2008 for large accelerated filers and January 1, 2009 for all other companies. The SEC has not yet published the new rules (*New York Times*, 6/20/07, p. C10)

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Lower Threshold for S-3 and F-3 Primary Offering Eligibility Proposed

On June 20, the Securities and Exchange Commission proposed amendments to the eligibility requirements of Form S-3 and Form F-3 to allow issuers (other than shell companies) to conduct primary offerings on such forms without regard to their public float or the rating of debt securities offered, so long as issuers satisfy the other eligibility requirements of the form and do not sell more than 20% of their public float in primary offerings pursuant to such new requirements in any 12 month period. Currently, issuers are only eligible to use Form S-3 and Form F-3 for primary offerings if their public float (market value of voting and non-voting common equity held by nonaffiliates) is $75 million or more, or for investment grade debt.

http://www.sec.gov/rules/proposed/2007/33-8812.pdf

Broker Dealer

SEC Issues First Compliance Alert

The Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) issued its first "Compliance Alert" setting forth deficiencies and weaknesses in compliance and supervisory controls identified from recent inspections.

OCIE highlighted the following six areas for broker-dealers: Sales of Section 529 College Savings Plans; Sales of Collateralized Mortgage Obligations; Sales of Real Estate Investment Trusts; Supervisory Procedures to Ensure Compliance with Regulation SHO; Charges in Separately Managed Accounts; Part-Time Financial and Operational Principals; and Expense Sharing Arrangements.

OCIE identified the same core issues with respect to each of these areas. According to OCIE, many firms appeared to lack adequate written supervisory procedures or supervisory processes, and the examiners found indications of inadequate and potentially misleading disclosures to investors concerning the risk of the investments. Examples include not providing investors with NASD-required educational materials, presenting sales literature to investors that appeared to be unbalanced and misleading concerning the risks and yields of the securities, and the selling of the most complex and riskiest classes of securities to retail customers.

OCIE identified issues in the following four areas in the case of investment advisors and mutual funds: Closed-End Fund Distributions; Performance Advertising Deficiencies; Mutual Funds "As-Of" Transaction Practices; and Advisors' Disaster Recovery Plans. OCIE identified misleading information as the key compliance concern with respect to the first three areas.

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

Joint Guidance on Review and Supervision of Electronic Communications Proposed

The National Association of Securities Dealers, Inc. and the New York Stock Exchange LLC (together, SROs) have published for comment guidance on the review and supervision of electronic communications. The SROs stated that this review of internal and external communications, incoming and outgoing, may be employed using risk-based principles, but must also include matters the SROs require to be reviewed – e.g., communications between research and investment banking, customer complaints, and order error or account designation change. The guidance sets forth the tests for employing risk-

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based procedures.

The proposed guidelines address the following six areas:

- Written policies and procedures are adopted governing the use and supervision of electronic communications, including what is and is not permitted.

- The forms of electronic communication employees are permitted to use, how the firm will review and supervise them and what is prohibited – e.g., personal electronic devices, third party e-mail services, message boards and electronic faxes.

- Identify the persons responsible for review, when and how they can delegate these functions and the criteria for such delegation and persons to whom delegated.

- How the review will be conducted – use of a hot list of phrases, percentage of an office or business area e-mails, percentage of each person's e-mails and a periodic assessment of the effectiveness of these methods.

- Frequency of review and time frame from sending or receiving the e-mail to its review and follow-up actions, if appropriate.

- Documenting the review, either in paper or electronic format, identifying a reviewer, documents reviewed, date of review and steps taken as a result of identified significant regulatory issues.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_019298.pdf

NYSE Allows Trading in All Markets from Floor Booth

In a June 8 rule filing with the Securities and Exchange Commission by the New York Stock Exchange LLC that the SEC declared effective immediately, the NYSE adopted rules to allow member firms to trade securities in all markets from their booth on the NYSE floor, subject to certain conditions. In a series of Information Memos and Member Education Bulletins issued in 2005 and 2006, the NYSE allowed firms to trade in securities listed on Nasdaq and equities listed on NYSE Arca from their floor booth.

The new rules and related conforming rule changes would permit member organizations to operate within their booth premises similar to a member organization's "upstairs" office. To do so, a member firm must obtain prior NYSE approval. Member firms doing so will have to comply with all NYSE rules applicable to a public business. Booth personnel will have to have the required registrations and there needs to be independent compliance personnel and proof of adequate supervisory control. The NYSE needs to be given detailed information regarding the proposed system and order handling process as well as evidence that the firm has adequate, NYSE pre-approved, written procedures and guidelines to supervise the booth personnel and their activities and a process for periodic review of these procedures and guidelines. The NYSE will periodically examine a member firm's business conducted at its approved booth premise.

Finally, firms are prohibited from executing from the floor booth any transaction for their own account, the account of an associated person and an account with respect to which they or an associated person exercises investment discretion.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-11941.pdf

Private Investment Funds

Legislation Regarding Publicly Traded Partnerships

U.S. Senators Baucus and Grassley have introduced a bill aimed at taxing as corporations partnerships that make their interests available on an exchange or market and that earn income from investment adviser and related asset management services. Although a publicly traded partnership generally is treated as a corporation for Federal tax purposes, under the current rules, advisory partnerships that are traded on an exchange can avail themselves of an exception from corporate treatment if 90% or more of their gross income is "qualifying income" as defined in the Internal Revenue Code of 1986, as amended (the Code). The proposed legislation amends §7704(c)(2) of the Code by providing that this exception from corporate treatment does not apply to partnerships providing certain investment adviser and related asset management services.

The legislation applies only to advisory entities that would be publicly traded partnerships but for the qualifying income exception, and does not apply to hedge funds or private equity funds. The bill provides that the amendment would apply to taxable years of a partnership beginning on or after June 14, 2007. Partnerships that filed a registration statement with the Securities and Exchange Commission relating to an IPO or had interests that were traded on an established securities market or were readily tradable on a secondary market on June 14 would not be subject to the new rule until taxable years of the partnership beginning on or after June 14, 2012.

http://www.senate.gov/~finance/sitepages/legislation.htm

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Banking

OTS Enters Into Consumer Complaint Sharing Agreement with CSBS

The Office of Thrift Supervision (OTS) and the Conference of State Banking Supervisors (CSBS) announced agreement on June 14 on a model for sharing consumer complaint information between the OTS and state banking regulators.

The agreement, a Memorandum of Understanding (MOU), is intended to serve as a model for the sharing of individual consumer complaints for processing by the OTS or the appropriate state banking agency. It also provides for periodic reports of the number of complaints forwarded to the states or the OTS, the disposition of such complaints, and other summary information.

The MOU, according to OTS, is similar to a model agreement that the OTS and the National Association of Insurance Commissioners signed several years ago. It is anticipated that the MOU will assist consumers in ensuring that, where a state regulator or the OTS is responsible for supervising their financial institution, their complaint is routed to the proper regulatory authority to obtain a timely response.

http://www.ots.treas.gov/docs/7/777043.html

FDIC Releases Current Issue of "Supervisory Insights"

On June 21, the Federal Deposit Insurance Corporation (FDIC) issued its summer installment of its *Supervisory Insights* newsletter, a publication

BANKING

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prepared by the agency's Division of Supervision and Consumer Protection that is intended to be a "forum for discussing how bank regulation and policy are put into practice in the field, sharing best practices, and communicating about the emerging issues that bank supervisors face." Articles in the current installment include the following:

- *Third-Party Arrangements: Elevating Risk Awareness*. This article describes the experiences some FDIC examiners have had with respect to their examination of third-party relationships. As noted by the authors, although these relationships can assist institutions in attaining strategic objectives, "failure to manage these risks can expose a financial institution to everything from financial loss to regulatory action and loss of customer relationships." Specific case studies are discussed.

- *Staying Alert to Mortgage Fraud*. This article discusses recent mortgage fraud activity, including the proliferation of nontraditional mortgage loan products in recent years.

- *Wind Hazard Insurance*. This article addresses "potentially widespread issues regarding insurance availability and affordability" and the resulting significant consequences. In particular, this article focuses on Florida and the impact of the state's climate on its residents' ability to procure wind hazard insurance.

Regular features found in the newsletter are also included.

http://www.fdic.gov/regulations/examinations/supervisory/insights/sisum07/index.html

FDIC Issues Final Guidelines on Affordable Small-Dollar Loans

On June 19, the Federal Deposit Insurance Corporation (FDIC) issued guidelines to state nonmember banks aimed at helping consumers avoid reliance on high-cost borrowings, while enabling insured institutions to better serve an under-utilized market. The guidelines are intended to raise awareness and encourage financial institutions to offer small-dollar credit products that are affordable, provide better terms than those typically available to consumers (e.g., fee-based overdraft programs and payday lending), and establish long-term relationships with new customers.

Under the new guidelines, FDIC-supervised institutions that offer such products, structured in a responsible manner, may receive favorable consideration under the Community Reinvestment Act.

http://www.fdic.gov/news/news/press/2007/pr07052a.html

United Kingdom Developments

Hedge Funds to Consider Voluntary Code of Conduct

On June 19, former Bank of England deputy governor Sir Andrew Large announced that he had been recruited to lead a study into voluntary standards for the hedge fund industry. The study has been initiated by a working group of 13 of the largest hedge funds, including Man Group and GLC Partners.

The working group said the study will be carried out in the context of the UK Financial Services Authority's more principles-based regulatory approach. The group will begin by reviewing existing principles, standards and guidelines.

The 13 initial hedge fund managers involved are: Brevan Howard, Brummer &

UK DEVELOPMENTS

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Partners, Centaurus Capital, Cheyne Capital, CQS, GLG, Gartmore, Landsdowne Partners, London Diversified, Man Group, Marshall Wace, Och-Ziff and RAB Capital Plc.

http://www.ft.com/cms/s/cefe07d4-1ddd-11dc-89f7-000b5df10621.html

FSA Publishes Annual Report

On June 21, the Financial Services Authority (FSA) published its Annual Report for the year 2006/07. The report details FSA's work in the previous year under three headings: (i) promoting efficient, orderly and fair financial markets; (ii) helping retail consumers achieve a fair deal; and (iii) improving business capability and effectiveness.

The FSA continued to review existing regulations to see where unnecessary regulations may be eliminated or replaced with principles and the FSA's Chairman, Callum MacCarthy, acknowledged that more problems lie within the retail market than in wholesale and cited as reasons complex products, information asymmetries and low levels of consumer awareness.

For the year 2006/07, the FSA had set 74 targets, of which 61 were delivered on time and eight were delayed but still delivered in the financial year. Five are still outstanding.

The FSA's enforcement division closed 219 investigations. The Regulatory Decisions Committee considered 17 new cases as opposed to 46 last year and the FSA levied £14.66 million in financial penalties during the year compared to £17.43 million for the previous year.

http://www.fsa.gov.uk/pages/Library/Corporate/Annual/ar06_07.shtml

Litigation

Violations of GAAP and Issuance of Restatement Fail to Support PSLRA Claims

Purchasers of securities brought a federal securities law class action against Ferro Corporation and two of its officers alleging, among other things, that defendants encouraged their employees to manipulate financial results in order to meet market expectations. In dismissing plaintiff's second amended complaint with prejudice, the Court noted that it failed to meet the heightened pleading standards applicable to actions under the PSLRA. References to so-called silence agreements with former employees, a claimed culture of fear, and information provided by confidential witnesses were too vague and lacking in factual particularity to support allegations that any statements issued by defendants were knowingly false or misleading when made. (*In re Ferro Corp. Sec. Litig.* 2007 WL 1691358 (N.D. Ohio June 11, 2007))

Mere Mention of Federal Securities Laws Does Not Support Federal Jurisdiction

Claims that defendants engaged in fraudulent or deceitful practices in connection with the sale of certain debentures, based entirely on state law, referred, in one paragraph, to violations of the Securities Act of 1933, the Securities Exchange Act of 1934, and the Investment Advisors Act of 1940. After the District Court questioned whether it had subject matter jurisdiction, the parties argued that the "mere mention" of the federal securities laws in a count of the complaint asserting a claim under state law was sufficient to establish federal question jurisdiction. Disagreeing with that position and holding, instead, that the "mere mention" of federal statutes in a state law

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count cannot convert it to a federal count or otherwise support subject matter jurisdiction, the Court dismissed the complaint for lack of subject matter jurisdiction. (*Miller v. Cabell Financial Corp*., 2007 WL 1725323 (N.D. Ohio June 13, 2007))

Anti-Money Laundering

Guidance Issued Regarding SAR Supporting Documentation

The Financial Crimes Enforcement Network (FinCEN) has issued guidance providing that financial institutions, including banks, broker-dealers and futures commission merchants, are under an obligation to provide "supporting documentation" related to the filing of any particular suspicious activity report (SAR) when requested to do so by an applicable law enforcement or regulatory agency (including FinCEN). For these purposes, "supporting documentation" includes any documents or records that assisted the firm in its determination that the subject activity warranted the filing of an SAR. The guidance also clarifies that the federal Right to Financial Privacy Act does not apply when providing SAR-related information to FinCEN or any other applicable agency. FinCEN additionally advised financial institutions to request written confirmation from a supervisory agent or attorney within a federal or state or local agency's office, as applicable when any such agency requires a firm to keep an account which is the subject of a SAR filing open after the firm has determined that potential illegal activity has occurred in connection with the account.

http://www.fincen.gov/Supporting_Documentation_Guidance.pdf

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