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Corporate and Financial Weekly Digest

June 29, 2007

A Note from the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published next Friday, July 6, due to the Fourth of July holiday. The next issue will be distributed on July 13.

Robert Kohl

SEC/Corporate

SEC Proposes Amendments to Rule 144 and Rule 145

On June 22, the Securities and Exchange Commission proposed amendments to Rule 144 which would, among other things:

- shorten the required holding period for restricted securities of reporting companies to six months;
- toll the holding period for up to six months for restricted securities if a holder engaged in certain hedging transactions;
- eliminate manner of sale restrictions with respect to debt securities;
- increase Form 144 filing thresholds and integrate Form 144 and Form 4 filing requirements; and
- codify several staff interpretive positions on Rule 144, including those relating to surrender of other securities of the same issuer and cashless exercise of derivative securities.

The SEC also proposed amendments to Rule 145 to eliminate the presumptive underwriter position in Rule 145(c) (other than for shell company transactions) and to revise the resale requirements in Rule 145(d).

http://www.sec.gov/rules/proposed/2007/33-8813.pdf

SEC Releases Final Rule and Interpretive Guidance on Management Assessment Report on Internal Controls

On June 20, the Securities and Exchange Commission issued an interpretive release to provide guidance for management regarding the evaluation and assessment of internal control over financial reporting required under Section 404 of the Sarbanes-Oxley Act of 2002, providing a procedure to conduct a

SEC/CORPORATE

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top-down, risk-based evaluation of internal controls. The evaluation process guidance explains the identification of financial reporting risks and the evaluation of whether the controls management has implemented adequately address those risks, as well as an approach for making judgments about the methods and procedures for evaluating whether the operation of internal control over financial reporting is effective.

On June 20, the SEC also issued a final rule (i) providing that an evaluation that complies with its new interpretive guidance is one way (but not the only way) to satisfy the requirement for management's report assessing internal controls under Section 404, (ii) defining the term "material weakness," and (iii) revising the requirements regarding the auditor's attestation report on the effectiveness of internal control over financial reporting to clarify that the auditor must directly express an opinion on the effectiveness of internal control over financial reporting, not simply on management's assessment of such controls. "Material weakness" is defined by the new rule as a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the registrant's annual or interim financial statements will not be prevented or detected on a timely basis.

http://www.sec.gov/rules/interp/2007/33-8810.pdf

http://www.sec.gov/rules/final/2007/33-8809.pdf

Broker Dealer

SEC Adopts Final Amendments to Short Sale Rules

The Securities and Exchange Commission has published final rules that eliminate the price test of SEC Rule 10a-1 and prohibit any self-regulatory organization from having its own price test regarding short sales. The rule changes also eliminate the related "short exempt" marking requirement under Rule 200(g) of Regulation SHO.

The compliance date for the rule change is July 6.

http://www.sec.gov/rules/final/2007/34-55970.pdf'

NYSE Arca Adds PSO Order Type

NYSE Arca has amended its rules to add a new order type, the Primary Sweep Order (PSO), which is a variation on Arca's existing Primary Only order type (PO Order). Unlike the existing PO Order, which must be entered before 6:28 a.m. Pacific Time and is restricted to participation in the primary market opening without first sweeping the NYSE Arca book, a PSO may be entered at any time and will sweep the NYSE Arca book before routing to the primary, listing market. Unless a PSO is designated as immediate-or-cancel, the routed order (or the unexecuted portion thereof) will remain on that market until executed or cancelled. A PSO may be designated as an intermarket sweep order, subject to the provisions of Regulation NMS.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-11719.pdf

NASD Extends Closing Time of NASD/NYSE Trade Reporting Facility

The National Association of Securities Dealers has adopted rule changes extending the closing time of the NASD/NYSE Trade Reporting Facility (NASD/NYSE TRF), which provides NASD members with a mechanism for

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reporting locked-in, off-exchange transactions in exchange-listed securities, from 6:30 p.m. to 8:00 p.m. Eastern Time. The extended closing time conforms with the system closing time of the NASD/Nasdaq Trade Reporting Facility, which also was extended to 8:00 p.m. in late 2006.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-12092.pdf

Private Investment Funds

Bill Introduced that Would Tax "Performance Allocations" as Ordinary Income

On June 22, a bill was introduced in the House of Representative that would amend the Internal Revenue Code of 1986 to tax as ordinary income the "performance allocation" or "carried interest" received by a partner that provides advisory services to the partnership. Under existing law, a performance allocation is taxed as capital gains to the extent that the income being allocated is taxable as capital gains and taxed as ordinary income to the extent that the income being allocated is taxable as ordinary income. The legislation would apply to any investment management firm that receives as compensation for its advisory services a portion of an investment partnership's profits. The legislation does not impact the tax treatment of income and loss received by a partner providing advisory services in respect of actual capital contributed to the partnership.

The bill, H.R. 2834, was introduced by representatives Sander Levin, Charles Rangel, Barney Frank, Pete Stark, Jim McDermott, John Lewis, Richard Neal, Earl Pomeroy, Stephanie Tubbs Jones, John Larson, Earl Blumenauer, Ron Kind, and Bill Pascrel. The bill does not provide for an effective date.

http://thomas.loc.gov/cgi-bin/query/z?c110:H.R.2834.IH:

Banking

Banking Agencies Issue Final Statement on Subprime Mortgage Lending

The federal financial regulatory agencies today issued a final *Statement on Subprime Mortgage Lending* to address issues relating to certain adjustable-rate mortgage (ARM) products that can cause payment shock. The statement describes the safety and soundness and consumer protection standards that institutions should follow to ensure borrowers obtain loans they can afford to repay. These standards include a fully indexed, fully amortized qualification for borrowers and cautions on risk-layering features, including an expectation that stated income and reduced documentation should be accepted only if there are documented mitigating factors that clearly minimize the need for verification of a borrower's repayment capacity. Consumer protection standards include product disclosures to customers and limits on prepayment penalties that allow for a reasonable period of time, typically at least 60 days, for customers to refinance prior to the expiration of the initial fixed interest rate period without penalty.

The statement reinforces the April 17, 2007 interagency *Statement on Working with Borrowers*, in which the agencies encouraged institutions to work with residential borrowers who are financially unable or are expected to be unable to meet their contractual payment obligations. The agencies stated that workout arrangements that are consistent with safe and sound lending practices are generally in the long-term best interest of both the financial institution and the borrower.

http://www.fdic.gov/news/news/press/2007/pr07055a.html

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United Kingdom Developments

FSA Publishes First Papers from Its Retail Distribution Review

On June 27, the UK Financial Services Authority (FSA) published the first proposals for discussion from its Retail Distribution Review (RDR) project launched in June 2006. DP07/1 *A Review of Retail Distribution* follows six months of work looking at the causes of problems in the UK retail investment market.

The discussion paper seeks views on current market standards, including the growth in the use of online trading platforms, cost-effective ways of providing advice to a wider range of consumers and improving consumer understanding.

A core proposal of the paper is the improvement of the regulated investment advice market by dividing it into two parts: (i) professional financial planning and advisory service, and (ii) primary advice.

The comment period will end on December 31 and the FSA aims to publish a feedback statement in Q2 2008.

A companion discussion paper, DP07/2 *Platforms: the role of wraps and fund supermarkets* with the same comment period, seeks industry views on standards that should be met by online platforms used by intermediaries (and sometimes consumers directly) to view and administer investment portfolios.

http://www.fsa.gov.uk/pubs/discussion/dp07_01.pdf

http://www.fsa.gov.uk/pubs/discussion/dp07_02.pdf

Litigation

Supreme Court Vacates Seventh Circuit Securities Fraud Decision

In an important decision concerning the standard for pleading scienter in securities fraud cases, the Supreme Court vacated a decision by the Seventh Circuit Court of Appeals, and ruled that the Private Securities Litigation Reform Act (PSLRA) requires courts to consider plausible competing inferences in determining whether a plaintiff has alleged facts sufficient to give rise to the "strong inference" of scienter that Congress mandated in the PSLRA. In reaching this decision, the Supreme Court rejected the Seventh Circuit's standard that a plaintiff need only plead sufficient facts such that a reasonable person could infer that the defendant acted with the requisite intent to defraud shareholders to survive a motion to dismiss. Instead, the Supreme Court ruled that it was not sufficient for the inference of scienter to be "reasonable," that courts must consider competing innocent inferences, and that a plaintiff's allegations of scienter would only be sufficient "if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference."

The Seventh Circuit had expressed concern that if a court were required to compare and assess competing inferences at the pleading stage, it might usurp the fact-finding role normally delegated to a jury pursuant to the Seventh Amendment. The Supreme Court disagreed, explaining that Congress has the authority to determine what must be pleaded to state a claim, thereby conferring upon courts the power to act as gatekeepers to prevent the submission of inadequately pleaded claims to a jury. The Supreme Court held that Congress unquestionably raised the pleading standards for scienter when it enacted the PSLRA. Accordingly, while confirming that courts must continue

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to assume the truth of a plaintiff's allegations at the pleading stage, the Supreme Court ruled that the comparative assessment of plausible inferences to be drawn from such allegations would not deprive litigants of their constitutional right to a jury. (*Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 2007 WL 1773208 (U.S. June 21, 2007))

CFTC

CFTC Proposes Recordkeeping Requirements for OTC Transactions

The Commodity Futures Trading Commission Regulation 18.05 currently requires every person holding or controlling a reportable futures or option position on a designated contract market (DCM) or registered derivatives transaction execution facility (DTEF) to retain books and records and make available to the CFTC upon request any pertinent information with respect to other positions, transactions or activities in the underlying commodity in which such person has a reportable position. The CFTC is proposing to amend Regulation 18.05 explicitly to require that persons holding or controlling reportable positions on a "reporting market" (a DCM or DTEF) retain books and records and make available to the CFTC upon request any pertinent information with respect to all other positions and transactions in the commodity in which the trader has a reportable position, including positions and transactions pursuant to the statutory exemptions for swaps and other OTC transactions.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-12045.pdf

CFTC Names Walter Lukken Acting Chairman

On June 27, the Commodity Futures Trading Commission announced the resignation of Chairman Reuben Jeffery III, effective June 27, 2007. Jeffery has served as Chairman of the CFTC since July 2005. Walter Lukken has been elected to serve as Acting Chairman. Lukken will exercise the executive and administrative functions of the CFTC until a new Chairman has been appointed by the President and confirmed by the Senate.

http://www.cftc.gov/opa/press07/opa5347-07.htm

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