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Corporate and Financial Weekly Digest

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SEC/Corporate

2007 SEC Corporation Finance Projects Outlined

In a February 23 speech at the Annual Conference on Securities Regulation and Business Law, John White, the Director of the Division of Corporation Finance of the Securities and Exchange Commission, outlined various projects that are on the Division's near-term calendar for 2007.

Two items that Mr. White indicated were imminent were foreign issuer deregistration and internet availability of proxy materials (or E-Proxy). In December 2006, the Commission voted to issue a revised proposal concerning amendments to its rules regarding how foreign private issuers may terminate their registration with the Commission. Mr. White indicated that the Division hopes to make a recommendation for a final rule in the very near future.

In 2006, the Commission also adopted rules allowing companies to deliver proxy materials by a "notice and access" model, which would allow the posting of proxy materials electronically rather than sending paper copies. However, the Commission has also proposed and sought comments on an expansion of this model which would require that electronic proxy materials be available for shareholders of all public companies. Mr. White indicated that the Division will move quickly following the end of the comment period on March 30 to make a recommendation for a final rule to the Commission.

Mr. White also discussed the Commission's upcoming roundtable on International Financial Reporting Standards (IFRS), which will explore the current state of the "roadmap" laid out by the former SEC Chief Accountant as to how the Commission might eliminate the requirement that companies filing IFRS financial statements reconcile those with U.S. Generally Accepted Accounting Principles. Mr. White suggested that the Commission will be devoting considerable attention following the roundtable to developing and announcing next steps and indicated that he believed the time when the staff would recommend the "end of reconciliation" was clearly in sight.

Among the other things Mr. White discussed were the following:

- The Division is developing a plan for targeted reviews of the newly required executive compensation disclosure in proxy statements and will issue guidance to assist in conveying the Division's observations to issuers for the 2008 proxy season;

- To further its focus on Extensible Business Reporting

SEC/CORPORATE

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Language, or XBRL, the SEC plans to apply interactive data to certain of the new executive compensation disclosures, and will make some of such data available to the public on a demonstration basis;

- The Commission continues to look at possible rulemaking in the area of shareholder access to corporate proxies, with a goal to act in time for the 2008 proxy season; and

- The Division is studying various methods of private offering reform and relief for small business capital raising and hopes to issue a proposal by this summer.

http://www.sec.gov/news/speech/2007/spch022307jww.htm.

Broker Dealer

NYSE Proposes Rule Changes to Conform to NASD Rules

In February 2006, the Securities and Exchange Commission approved the merger of the New York Stock Exchange with Archipelago Holdings, Inc. conditioned on, among other things, an undertaking by the NYSE to work with the National Association of Securities Dealers, Inc. to eliminate inconsistent rules. To do this, the NYSE established a Compliance Advisory Group of NYSE staff and member firm representatives to make recommendations to the NYSE and NASD. Four subcommittees were established – Member Firm Organization/Structure and Governance; Supervision; Registration, Qualification and Continuing Education; and Sales Practices.

Because of the pending merger of segments of NYSE Regulation and NASD, NYSE arbitration rules were not fully addressed as it is unlikely that NYSE arbitration facilities will continue after the merger. Also, rules dealing with NYSE market operations are unique to the NYSE and were not addressed. A total of 128 rules are to be amended - 21 Sales Practice Rules, 9 Financial Operational Rules, 10 Buy-In Rules and 88 rules relating to member trading, proxy, account and credit operations, and replacement of the terms “member” and “allied member.”

http://apps.nyse.com/commdata/pub19b4.nsf/docs/03089F7D7251E2AC8525728F00740F67/$FILE/NYSE-2007-22%20Omnibus%20SRO%20Harmonization.pdf

http://apps.nyse.com/commdata/pub19b4.nsf/docs/16AB69128AB4B5EE852572900051D06B/$FILE/SRO%20Harmonization%20Report%20for%20NYSE-2007-22.pdf

SEC Proposes Order Exempting a Family Management Company from the Investment Advisers Act

The Securities and Exchange Commission gave notice for public comment of an application by Gates Capital Partners (Gates) and Bear Creek, Inc. for exclusion from the definition of investment adviser under the Investment Advisers Act of 1940. Gates was formed to manage investment of the lineal descendants of Charles C. and Hazel R. Gates, their spouses, trusts for their benefit, companies owned by them and present and future pooled investment vehicles owned by them and senior management of Bear Creek.

Gates currently manages Evergreen 37, LLC, a pooled investment vehicle owned by the owners of Gates and senior management of Bear

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Creek that is exempt from the definition of investment company under Section 3(c)(1) of the Investment Company Act of 1940. Bear Creek serves as trustee of trusts formed or to be formed in the future for Gates family members. Neither Gates nor Bear Creek holds itself out to the public as an investment adviser, and their sole clients are and will be family members.

http://www.sec.gov/rules/ia/2007/ia-2590.pdf

NASD Notifies Members of Important Topics in Examinations

The National Association of Securities Dealers, Inc. in a February 13 letter to member firms addressed eleven regulatory topics it will focus on in its forthcoming examinations. The NASD will generally notify a firm 30 days in advance of a routine examination as opposed to the current practice of 14 days advance notice. It has established a liaison program with a District office staff member assigned to each firm as a point of contact for regulatory comments and questions. NASD will verify the accuracy of the Central Registration Depository filings and confirm that filings now required to be made electronically under 11 Securities and Exchange Commission rules have been made.

Regulation S-P on customer privacy will be an item of focus. The NASD also will look at the member's practices in offering hedge funds to customers. Additionally, while NASD Rule 2711 on research reports does not apply to fixed income research, the NASD will check to see if members are following the best practices in this area recommended by the Bond Market Association (subsequently merged into the Securities Industry and Financial Markets Association). Attached to the letter was a listing of previously issued guidelines and the Notices to Members providing guidance in the 11 areas of focus. Also attached was a reference to reports and speeches relating to these 11 areas of focus.

http://www.nasd.com/web/groups/corp_comm/documents/home_page/nasdw_018635.pdf

Banking

OTS Issues Gift Card Guidance

The Office of Thrift Supervision (OTS) announced on February 28 the issuance of guidance on gift cards. The guidance is intended to assist OTS-regulated savings banks in ensuring adequate account administration, marketing, and sound consumer disclosure practices for gift card programs. The guidance encourages more uniform practices among thrifts that offer gift card programs, and supports institutional efforts to improve consumers' understanding of gift card features while also encouraging product innovation.

In issuing the guidance, the OTS noted that gift cards continue to grow in popularity and are projected to increase in volume. Currently, approximately 20 percent of OTS-regulated institutions offer some form of gift card program. Pursuant to the guidance, thrifts must have adequate policies and procedures in place to administer gift card programs, as well as a framework to address inherent program risks. Thrifts must also ensure that they provide customers adequate information about the gift cards they offer, including disclosures on fees and expiration dates. Finally, the guidance reminds institutions to avoid the use of misleading promotional materials.

http://www.ots.treas.gov/docs/4/480932.pdf

BANKING

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Proposed Assessment Rate Adjustment Guidelines for Large Institutions and Insured Foreign Branches

The Federal Deposit Insurance Corporation is seeking comment on proposed guidelines for determining how adjustments of up to 0.50 basis points would be made to the quarterly assessment rates of insured institutions defined as large (generally over $10 billion) Risk Category I institutions, and insured foreign branches in Risk Category I, according to the Final Assessments Rule (71 FR 69282, Nov. 30, 2006). These guidelines are intended to further clarify the analytical processes and the controls applied in making assessment rate adjustments. Comments on these proposed guidelines are due by March 23.

As indicated in the Final Assessments Rule, the initial assessment rates of large institutions in Risk Category I will be determined by a combination of supervisory ratings, long-term debt issuer ratings, and financial ratios for institutions that have no long-term debt issuer ratings. The Final Assessment Rule also indicated that FDIC may determine, in consultation with the primary federal regulator, whether limited adjustments to these initial assessment rates are warranted based upon consideration of additional risk information. Although the FDIC expects that such adjustments will be made relatively infrequently and for a limited number of institutions, FDIC believes that adjustments may on occasion be necessary to preserve consistency in the orderings of risk indicated by these assessment rates, ensure fairness among all large institutions, and ensure that assessment rates take into account all available information that is relevant to the FDIC's risk-based assessment decision.

Institutions are encouraged to provide comment on all aspects of the proposed guidelines as well as comment on directed questions pertaining to whether and how the FDIC should evaluate various categories of information such as stress considerations, qualitative loss severity information, the potential availability of parent company and affiliate support, risk information developed from the implementation of proposed international capital standards, and the existence of supervisory orders that may be less directly related to an institution's safety and soundness.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-2906.pdf

Supervisory Guidance Related to Basel II Implementation

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (agencies), are seeking comment on proposed guidance describing current agency expectations for banking organizations that would adopt the Advanced Internal Ratings-Based Approach (IRB) for credit risk and the Advanced Measurement Approaches (AMA) for operational risk under the proposed new Basel II capital framework. The proposed guidance also establishes the process for supervisory review and the implementation of the capital adequacy assessment process under Pillar 2 of the Basel II framework. The agencies will accept comments on the proposed guidance through May 29.

Highlights:

- The proposed guidance applies only to banking organizations that would implement the proposed Basel II framework.
- The proposed guidance highlights regulatory standards that are primarily principles-based.
- The proposed guidance is intended to provide banks with a clear description of the essential components and characteristics of an acceptable IRB framework.
- The proposed guidance identifies supervisory standards that banks should follow to implement and maintain an acceptable AMA framework for regulatory capital purposes.
- The proposed Pillar 2 guidance addresses the three fundamental objectives in the supervisory review process under Pillar 2: the comprehensive supervisory assessment of capital adequacy, a bank's compliance with regulatory capital requirements, and a bank's implementation of an internal capital adequacy assessment process.

http://www.occ.treas.gov/ftp/bulletin/2007-10.html
http://www.occ.treas.gov/fr/fedregister/72fr9083.pdf

Litigation

District Court Holds That Inquiry Notice Was Triggered But Denies Summary Judgment

Defendant moved for summary judgment on the grounds that plaintiffs' securities fraud class action was filed after the two year statute of limitations expired. The Court agreed that sufficient information about the possibility of fraudulent conduct was available to plaintiffs more than two years before commencement of the lawsuit. The Court found that this "inquiry notice" arose from, among other things, press reports regarding a Department of Justice investigation of price-fixing by defendant and other computer chip manufacturers, the filing of over 20 civil antitrust cases against defendant, and the link between defendant's stock price and the price of its computer chips.

Significantly, the Court ruled that "inquiry notice" alone did not trigger the statute of limitations and that the defendant also had to show that an investor "exercising reasonable diligence, should have discovered sufficient facts to satisfy the Private Securities Litigation Reform Act's heightened pleading requirements" more than two years before filing suit. With respect to this element, while the Court found that evidence was publicly available which "at first glance" could have enabled plaintiffs to satisfy the PSLRA's pleading standards, it held that whether or not a reasonable investor should have uncovered such evidence within the two-year limitations period presented a disputed question of fact that could not be resolved on a motion for summary judgment. (*In re Micron Technologies, Inc. Securities Litigation*, 2007 WL 576468 (D. Id. Feb. 21, 2007))

Plaintiffs Sufficiently Alleged Pattern of Racketeering Activity

The Fifth Circuit held that plaintiffs' allegations brought under the Racketeer Influenced And Corrupt Organizations statute (RICO) sufficiently pleaded a pattern of racketeering activity. The district court

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dismissed plaintiffs' RICO claims on the grounds that plaintiffs failed to allege that defendants' activities amounted to or posed a threat of *continuous criminal activity* and, therefore, failed to plead a pattern of racketeering as required by RICO. The Fifth Circuit found that the "continuity" element could be satisfied in a variety of ways and held that plaintiffs' allegations that, among other things, defendants' acts were committed over a two year period, involved repeated international travel, hundreds of victims and improper activities in both India and the United States, coupled with there being "no reason to suppose" the alleged wrongdoing would not have continued but for the filing of the lawsuit, sufficiently pleaded the "continuity" element for purposes of plaintiffs' RICO claim. (*Abraham v. Singh et al*, 2007 WL 575833 (5th Cir. Feb. 26, 2007))

CFTC

CFTC Amends Advertising Regulations for CPOs and CTAs

The Commodity Futures Trading Commission has amended its Regulation 4.41, which governs advertising by commodity pool operators (CPOs), commodity trading advisors (CTAs), and their principals. The amended regulation, which is effective March 26: (i) restricts the use of testimonials; (ii) clarifies the required placement of the prescribed simulated or hypothetical performance disclaimer; and (iii) makes explicit that advertisement through electronic media is included within the regulation's coverage.

Under the revised regulation, advertisements that refer to a testimonial must include certain prominent disclosures regarding the testimonial—specifically, that such testimonial may not be representative of all clients' experiences, that it is not a guarantee of future performance or success, and, if more than a nominal sum is paid, that it is a paid testimonial. The amended regulation also requires that the prescribed disclaimer for simulated or hypothetical performance be placed "in immediate proximity" to such performance information. These amendments generally conform the CFTC regulation with the terms of the National Futures Association Compliance Rule 2-29.

http://www.cftc.gov/opa/press07/opa5295-07.htm

"Enforcement Advisory on Cooperation" Revised

The Commodity Futures Trading Commission Division of Enforcement has revised its "Enforcement Advisory on Cooperation" concerning the attorney-client and work product privileges to clarify the Division's view on privileged materials and to assist prospective respondents and defendants and their counsel in assessing possible settlement positions and litigation risks.

The revised Advisory states that the Division, in evaluating whether a company cooperated with Division staff to a degree that would prompt the Division staff to recommend reduced sanctions to the Commission, may consider a company's (i) good faith in uncovering and investigating misconduct; (ii) cooperation with the Division's staff in reporting the misconduct and the company's actions with respect to it; and (iii) efforts to prevent future violations. The Division also may consider "additional factors" that may enhance or mitigate sanctions, but also may recommend enforcement even where all or most of the factors identified above are present.

http://www.cftc.gov/files/enf/enfcooperation-advisory.pdf

CFTC

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Disclosure Rules Proposed for FCMs Offering Sweep Accounts

The National Futures Association has proposed an interpretive notice requiring futures commission merchants (FCMs) that offer or recommend sweep accounts to make certain disclosures to their clients. The notice does not prescribe the disclosure language, but notes that FCMs should make the disclosures at the time a sweep account program is offered to a customer and requires each FCM to obtain the customer's written consent prior to any funds being transferred pursuant to such program.

Under the new notice, FCMs should (i) identify for their customers the entity maintaining the sweep account; (ii) determine whether that entity is subject to regulation; and (iii) disclose any material terms and conditions, risks and features of the sweep account program. In addition, FCMs should advise customers of any potential conflicts of interest in connection with the sweep account program and should inform customers of the consequences of transferring monies from the FCM's regulated customer accounts in the event that the entity maintaining the sweep account files for bankruptcy.

http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=1771

Offices Holding FCM Books and Records May Require Supervision

The National Futures Association has proposed to amend its Compliance Rule 2-10(b) to require futures commission merchants (FCMs) to keep their books and records in an office that is under the supervision of an individual resident in that office, who is a principal and is registered as an associated person (AP) of the FCM. Although FCMs are currently required to keep such books and records in an office that is located either in the U.S. or in a Part 30 jurisdiction, there is no requirement that the office be maintained by the FCM or that it be supervised by a principal and registered AP.

http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=1775

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