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SEC/Corporate

Financial Accounting Standards Board to Issue Final Guidance on Variable Interest Entities

The Financial Accounting Standards Board plans to issue, by March 31, final guidance relating to the consolidation of variable interest entities (VIEs). The guidance will be issued as a FASB staff position addressing how to determine the variability to be considered when applying FASB Interpretation 46(R), Consolidation of Variable Interest Entities (Interpretation 46(R)).

The VIEs addressed by the guidance are investment vehicles or partnerships which are controlled to some extent by one sponsoring or parent entity but also have other investors or participating interest holders. Generally, the VIE is consolidated on the balance sheet of the entity that controls it, but with multiple interest holders it is often unclear where this control rests. Prior to Interpretation 46(R), guidance rested on traditional concepts of majority ownership. Interpretation 46(R), according to the FASB's summary, broadened this to include consolidation by "primary beneficiaries if the entities do not effectively disperse risks among parties involved", which was a response to issuers who did not consolidate VIEs despite relationships that were similar to majority interests. "Primary beneficiary" was defined as "the party that absorbs a majority of the entity's expected losses, receives a majority of its expected residual returns, or both, as a result of holding variable interests". "Variable interests", in turn, are defined as contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests.

The staff position, which was cleared for final issuance subject to slight modification, addresses how a reporting enterprise should determine the variability to be considered when applying Interpretation 46(R). The staff position states that the variability to be considered in applying Interpretation 46(R) may affect (i) the determination as to whether the entity is a variable interest entity, (ii) the determination of which interests are variable interests in the entity, (iii) the calculation of expected losses and residual returns of the entity, and (iv) the determination of which party is the primary beneficiary of the VIE. FASB staff members noted in the proposed guidance that there is currently considerable variation in accounting practices with regard to determining variability in connection with applying Interpretation 46(R); for example, in considering variability connected to interest rate risk, some companies look at variability resulting from changes in cash flow while others look only at changes in fair values of cash flows.

The effective date for prospective application of the new guidance will be the first day of the first reporting period beginning after June 15, 2006. Retrospective application, which is optional, should be completed no later than the end of the annual reporting period ending after July 15, 2006. (*Securities Regulation and Law Report*, p. 495 (3/20/06))
http://www.fasb.org/project/variable_interest.shtml

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Banking

Agencies Seek Public Comment on Issues Related to the Accuracy of Consumer Credit Reports and the Reinvestigation of Disputes

The federal financial institution regulatory agencies and the Federal Trade Commission have jointly issued for comment an Advance Notice of Proposed Rulemaking (ANPR) on section 312 of the Fair and Accurate Credit Transactions Act (FACT Act).

The FACT Act requires the banking agencies and the FTC to: (1) establish guidelines regarding the accuracy and integrity of information furnished to consumer reporting agencies; and (2) prescribe regulations that require the entities that furnish such information to establish reasonable policies and procedures for implementing the guidelines. The FACT Act also requires the agencies to prescribe regulations that identify the circumstances under which an entity that furnishes information to consumer reporting agencies will be required to reinvestigate a dispute concerning the accuracy of information contained in a consumer credit report based on a consumer's direct request.

The FACT Act requires the agencies to consider specific issues as they develop guidelines and rules to implement section 312. The ANPR invites comment on issues relating to: (1) the factors that the agencies must consider for developing the accuracy and integrity guidelines; and (2) the considerations that the agencies must weigh before adopting rules that identify the circumstances in which entities that furnish information to consumer reporting agencies must reinvestigate direct consumer disputes.

Comments are due 60 days after publication in the Federal Register.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/06-2758.htm

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Private Investment Funds

IRS Issues Transition Relief on Deferred Compensation in Offshore Rabbi Trusts

On March 21, the Internal Revenue Service issued IRS Notice 2006-33 (2006-33, 2006-15, IRB 3/21/2006) providing transition relief for fee amounts that, prior to March 21, were set aside in an offshore trust or restricted in connection with a change in the service recipient's financial health (including any actual earnings on such amounts), provided that the deferred compensation arrangement is brought into compliance with Section 409A(b) (which became effective January 1, 2005) no later than December 31, 2007 (for example, by dissolving the trust or disassociating the trust from the deferred compensation plan). It became clear with passage of the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005 that fee income set aside in such trusts, also known as "rabbi trusts," would not qualify for tax deferral under Code Section 409A, but it was not clear previously how to bring such arrangements into compliance. The IRS has said that it intends to issue further guidance on what types of trusts or other arrangements would cause fee deferrals to fail to comply with Section 409A and pending such further guidance, taxpayers may rely on a reasonable, good faith interpretation of the applicable section.

Please note that this transition relief does not apply to assets that are set aside, transferred offshore or restricted or which become subject to additional restrictions on or after March 21. Fund managers with deferred compensation plans that have elections in place or other arrangements to transfer deferred compensation to such an offshore trust or with triggers related to the fund's financial health need to take action immediately. (*Notice 2006-33, 2006-15 IRB*, 3/21/2006)

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Litigation

Supreme Court Restricts Right to Pursue Holder Class Actions Based on State Law

In an 8-0 holding, the U.S. Supreme Court has reversed a decision limiting the preemptive effect of the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to those having a private remedy under provisions of the federal securities laws, such as Section 10(b) of the Securities Exchange Act of 1934. In rejecting the analysis of the 2nd Circuit, the Supreme Court agreed with the 7th Circuit that Congress intended SLUSA to preempt certain state law class action claims even if the federal securities laws provide no parallel remedy. The case at issue was a class action by a former broker on behalf of those who “continued to hold their stocks long beyond the point when, had the truth been known, they would have sold”. According to plaintiff, by the time “the truth was actually revealed . . . the stocks’ prices plummeted” and damages were incurred.

Because private actions under Rule 10b-5 may only be brought by purchasers or sellers of securities to remedy frauds associated with their own trades, that Rule does “not protect those who neither purchased nor sold the securities in question”. Thus, holders – those who neither purchase nor sell as a result of the alleged wrongdoing – cannot pursue claims thereunder. In holding that SLUSA limits the use of class actions to pursue claims under state statutory or common law arising from material misrepresentations or omissions relating to covered securities, the Supreme Court noted that Congress envisioned a broad construction of SLUSA to avoid litigation under state law that could frustrate the objectives of the Private Securities Litigation Reform Act of 1995. While SLUSA “does not deny any individual plaintiff or indeed any group of fewer than 50 plaintiffs, the right to enforce any state law cause of action parallel to claims that could be asserted under Rule 10b-5,” it does preclude use of the class action device to vindicate those claims. (*Merrill Lynch v. Dabit*, No. 04-1371, 2006 WL 694137 (U.S. Mar. 21, 2006))

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CFTC

District Court Concludes that Claims for the False Reporting of Natural Gas Prices are not Precluded under the Commodity Exchange Act

The District Court for the Northern District of Georgia refused to dismiss the Commodity Futures Trading Commission's claims that the defendants knowingly submitted false reports of market information to natural gas price indexes and intentionally attempted to manipulate the price of natural gas. The defendants argued that their alleged misconduct – the false reporting of natural gas prices – was exempted from the purview of the CFTC under § 2(g) and § 2(h)(1) of the Commodity Exchange Act since natural gas is an "exempt commodity." The Court, however, concluded that these exemptions did not apply because the alleged misconduct involved "reporting" activities, and not a "contract, agreement, or transaction" within the meaning of § 2(g) or § 2(h)(1). The Court also rejected the defendants' argument that the CEA does not cover the "cash forward contracts" alleged in the complaint after finding that "[t]he complaint centers around false reporting and attempted manipulation of gas prices," which plainly falls within the CEA's prohibition against "the manipulation of the price of any commodity." (*United States Commodity Futures Trading Commission v. Atha, et. al.*, No. 05-CV-0293 (N.D. Ga. March 17, 2006))

FERC Upholds New Manipulation Rule

The Federal Energy Commission upheld use of a five-year statute of limitation on the manipulation of wholesale power and natural gas markets. FERC concluded that Edison Mission Energy "misunderstood" the new anti-manipulation rule as outlined in Order No. 670, and rejected Edison's request for rehearing. The anti-manipulation rule was issued pursuant to the Energy Policy Act of 2005 and allows for enforcement actions under the Natural Gas Act and the Federal Power Act, which do not provide for a statute of limitations for the kinds of manipulation addressed by the FERC in its new rule. FERC found that because no statute of limitations directly applied, the Commission would only be limited by the existing federal code, which provided for a five-year statute of limitations.
(Available soon at http://www.ferc.gov/ under petition number 114 FERC 61,300)

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