

## CORPORATE & FINANCIAL

### WEEKLY DIGEST

March 25, 2011

#### SEC/CORPORATE

##### **SEC Schedules Open Meeting to Consider Dodd-Frank Rules Relating to Compensation Committees and their Consultants and Advisors**

On March 30, the Securities and Exchange Commission will hold an open meeting to discuss, among other matters, whether to adopt rules to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 952 requires the SEC to direct the national securities exchanges and national securities associations to prohibit the listing of equity securities of issuers (with certain exceptions) whose compensation committees do not comply with the independence and other requirements set forth in Section 952 of the Dodd-Frank Act. These requirements include that each compensation committee member be an "independent" (as defined by the SEC) director and that such committees have authority to engage, and be directly responsible for the appointment, compensation and oversight of the work of, independent compensation consultants, legal counsel, or other advisors to a compensation committee. Section 952 lists various "independence" factors for the SEC to consider. Section 952 also requires that issuers provide appropriate funding for purposes of retaining such compensation consultants and advisors. Finally, Section 952 of the Dodd-Frank Act directs the SEC to provide appropriate procedures for an issuer to have reasonable opportunity to cure any defects with respect to the requirements outlined above, and provides that Section 952 does not apply to a "controlled company."

[Read more.](#)

#### BROKER DEALER

##### **FINRA Amends Sanction Guidelines**

The Financial Industry Regulatory Authority has revised two sections of its Sanction Guidelines in response to recent FINRA disciplinary cases. In particular, the amendments:

- 1) specify a causation standard for restitution orders;
- 2) allow FINRA adjudicators to order damages be paid to those actually injured;
- 3) indicate that certain factors in determining sanctions may be more relevant than others in a given disciplinary matter; and
- 4) instruct FINRA adjudicators to consider other regulators' imposed sanctions in FINRA disciplinary matters.

The Sanction Guidelines provide guidance for crafting sanctions for potential violations of FINRA's rules. FINRA adjudicators and FINRA's Department of Market Regulation and Enforcement rely on these guidelines when determining sanctions and negotiating settlements in disciplinary matters. The Sanction Guidelines delineate General Principles Applicable to All Sanction Determinations (General Principles) and the Principal Considerations to be Used in Determining Sanctions (Principal Considerations).

## *Revisions to General Principles*

FINRA Sanction Guidelines permit FINRA adjudicators to order restitution to remediate misconduct. Restitution seeks to restore the status quo by "disgorging" the unjust enrichment of the wrongdoer. General Principle 5 allows adjudicators to calculate orders of restitution based on the actual amount of loss sustained due to the misconduct, and thus, FINRA restitution orders may exceed the amount of the "ill-gotten gain." The Securities and Exchange Commission requested that FINRA specify the causation standard required under General Principle 5 when restitution is ordered. Revised General Principle 5 clarifies that "proximate causation" is the required standard.

General Principle 6 recognizes FINRA adjudicators' ability to impose fines in the amount of the financial benefit derived from the wrongdoer's misconduct. The amendment to General Principle 6 allows FINRA adjudicators to order some or all of the amount payable by the wrongdoer be paid to harmed customers, in addition to applying the amount toward fines payable to FINRA.

## *Revisions to Principal Considerations*

FINRA revised its Principal Considerations generally to clarify that some of the enumerated factors used in determining sanctions will be more relevant than others in a given disciplinary matter. FINRA explains that not every enumerated factor will be aggravating or mitigating depending on the facts and circumstances of a case or the type of violation.

Principal Consideration 14 instructs FINRA adjudicators to consider sanctions imposed by other regulators arising from the same misconduct at issue. For example, FINRA adjudicators should consider sanctions imposed by state regulators in determining the appropriate sanctions in its own adjudications.

Click [here](#) to read FINRA Regulatory Notice 11-13.

# OTC DERIVATIVES

## **Implementation Schedule for Dodd-Frank Swap Rules**

With the July 16 general effective date of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act fast approaching, Commissioner Gary Gensler of the Commodity Futures Trading Commission outlined his thinking on the finalization and implementation of swap rules in a speech given to the Futures Industry Association on March 16.

With respect to finalization, Commissioner Gensler affirmed his desire to have all rule proposals (as opposed to final rules) completed by the end of April, with rules being finalized in the three broad groupings: the Early Group, the Middle Group and the Late Group.

These groups were not crisply defined by Commissioner Gensler, but some salient characteristics of each are noted below:

**Early Group**—To be finalized in the spring. Rules in this group will include, without limitation, entity definitions, registration requirements, the end-user exception from clearing, large position reporting and whistle-blowing.

**Middle Group**—To be finalized in the summer. Rules in this group will include, without limitation, rules relating to clearinghouses, business conduct standards for swap dealers, data and trading markets, as well as rules for agricultural swaps, governance rules for derivatives clearing organizations, designated contract markets and swap execution facilities, and rules for segregation for uncleared swaps.

**Late Group**—To be finalized in late summer and early fall. Rules in this group will include, without limitation, those relating to disruptive trading practices, product definitions, capital and margin requirements, supervision and testing requirements and conforming rules.

With respect to implementation, Commissioner Gensler said that he favored a pragmatic approach. "We are looking to phase in implementation, considering the whole mosaic of rules," he said. He stated in particular that the CFTC would use the flexibility given to it by the statute to specify effective dates no *earlier* than 60 days after the adoption of a final rule to provide for orderly implementation of related rules, explaining, "So, even if we finish

finalizing rules in a particular order, that doesn't mean that the rules will be required to become effective in that order. Implementation dates may be conditioned upon other rules being finalized. Furthermore, we are looking at phasing implementation dates based upon a number of considerations, possibly including asset class, type of market participant and whether the requirement would apply to market platforms, like clearinghouses, or to specific transactions, such as real time reporting. For example, we are considering whether a rule might become effective for one asset class or one group of market participants before it is effective for other assets or other groups of market participants."

The Commissioner's full speech can be found [here](#).

## CFTC

### CFTC Publishes a Proposed Interpretive Order on Disruptive Trading Practices under Dodd-Frank

The Dodd-Frank Wall Street Reform and Consumer Protection Act added a new Section 4c(a)(5) to the Commodity Exchange Act (CEA) regarding disruptive trading practices, which prohibits any trading, practice or conduct on or subject to the rules of a "registered entity" that (a) violates bids or offers; (b) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (c) is, is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

On March 18, the Commodity Futures Trading Commission published a proposed interpretive order regarding these disruptive trading practices under the Dodd-Frank Act (and simultaneously terminated a previously issued advance notice of proposed rulemaking on the same subject). The proposed interpretive order provides market participants with guidance regarding CEA Section 4c(a)(5) and addresses concerns by market participants in response to the advanced notice of proposed rulemaking. Items clarified by the proposed interpretive order include the scope of Section 4c(a)(5), what specific conduct and trading practices would violate the statute, what it means to "violate" bids or offers, and certain other terms set forth in the statute.

Specifically, the CFTC's proposed interpretation of CEA Section 4c(a)(5) provides for this purpose that:

- a "registered entity" includes a designated contract market (DCM) or swap execution facility (SEF), but not a swap data repository;
- CEA Section 4c(a)(5) does not apply to block trades or exchanges for related positions, even if transacted on a DCM or SEF;
- "closing period" means "the period in the contract or trade when the daily settlement price is determined under the rules of that trading facility" (although activity outside the closing period may be included in an investigation under CEA Section 4c(a)(5)(B)); and
- "spoofing" includes submitting or cancelling bids or offers to (1) overload the quotation system of a registered entity, (2) delay another person's execution of trades, or (3) create the appearance of market depth (subject to a good faith exclusion).

Further, the CFTC's proposed interpretation provides guidance on how the CFTC proposes to construe each of the three clauses of Section 4c(a)(5):

- Section 4c(a)(5)(A) forbids "buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price." The CFTC's proposed interpretation would deem such a purchase or sale to be in violation of Section 4c(a)(5)(A), regardless of the intent of the buyer or seller.
- In determining whether a violation has occurred under Section 4c(a)(5)(B), the CFTC will evaluate the facts and circumstances at the time of the relevant trading, practice or conduct. The CFTC's proposed interpretation, therefore, directs market participants to "assess market conditions and consider how their trading practices and conduct affect the orderly execution of transactions during the closing period."
- A violation under Section 4c(a)(5)(C) requires that a market participant have the intention to cancel a bid or offer before execution (as opposed to merely acting recklessly). An investigation of a violation of this provision will involve "evaluating all of the facts and circumstances of each particular case, including a person's trading practices and patterns."

Comments on the proposed interpretive order must be received by May 17. The *Federal Register* release is available [here](#).

## INVESTMENT COMPANIES AND INVESTMENT ADVISERS

### **SEC Provides Temporary Relief for Investment Companies Regarding Custody of Collateral to Support Cleared Interest Rate Swaps**

In a no-action letter issued on March 16, the Securities and Exchange Commission's Division of Investment Management extended temporary no-action relief under Section 17(f) of the Investment Company Act of 1940 to any registered investment company (Fund) if the Fund or its custodian places and maintains assets in the custody of LCH.Clearnet Limited (LCH), a U.K. derivatives clearing organization, or an LCH clearing member that is a futures commission merchant registered with the Commodity Futures Trading Commission for purposes of meeting LCH's or a clearing member's margin requirements for certain cleared interest rate swap contracts. The SEC relied, among other things, upon the following representations in deciding to flexibly apply the 1940 Act's custody requirements: (1) LCH and clearing members will address each of the requirements of Rule 17f-6 under the 1940 Act; (2) each clearing member will hold Fund assets as part of the over-the-counter derivatives account class; and (3) each clearing member will be required to segregate customer funds and securities from the clearing member's own assets. The SEC's temporary no-action position will expire on July 16, upon the conclusion of a one-year transition period following the effective date of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Click [here](#) to read the SEC's no-action letter.

## LITIGATION

### **Supreme Court Rejects Statistical Significance as Bright-Line Rule for Materiality**

The U.S. Supreme Court found that allegations of "statistical significance" were not a requirement for pleading materiality in a securities fraud action arising from a pharmaceutical company's alleged failure to disclose reports linking its cold remedy with loss of smell.

Plaintiff-shareholders alleged in the complaint that statements made by defendant Matrixx relating to revenues and product safety were misleading in light of reports that Matrixx had received, but did not disclose, concerning consumers who had lost their sense of smell after using Matrixx's Zicam cold remedy. Matrixx moved to dismiss the complaint, arguing, among other things, that plaintiff had failed to plead the elements of a material misstatement.

The district court granted defendants' motion to dismiss, finding that plaintiff had not alleged a statistically significant correlation between the use of Zicam and smell loss so as to make failure to publicly disclose the reports a material omission. The U.S. Court of Appeals for the Ninth Circuit reversed, holding that a materiality determination requires "delicate assessments" of what a "reasonable shareholder" would infer from a given set of facts, and found that the district court had erred by requiring that the plaintiff specifically allege the statistical significance of the reports to establish materiality.

The Supreme Court affirmed. It reasoned that Matrixx's argument relied upon the flawed premise that statistical significance is the only reliable indication of causation. The Court found that medical professionals and researchers do not limit the data they rely on only to statistically significant evidence, and courts frequently permit expert testimony on causation based upon evidence other than statistical significance. On this basis, the Court concluded that in certain cases reasonable investors could view non-statistically significant data as material, and thus no such allegation should be required to plead materiality. (*Matrixx Initiatives, Inc. v. Siracusano*, 2011 WL 977060 (U.S. March 22, 2011))

## District Court Dismisses Complaint for Failure to Adequately Plead Scienter

Plaintiff asserted a securities class action complaint against Nextwave Wireless Inc., as well as certain of its officers and directors. The complaint alleged that defendants made 17 statements that were false and misleading to investors over an extended period of time, and that as a result defendants were liable under Rule 10(b) of the Securities Exchange Act.

The court had dismissed plaintiff's prior complaint and directed plaintiff to file an amended pleading. Defendants moved to dismiss the amended complaint, arguing that the complaint failed to provide a plain and concise statement of plaintiff's claims as required by the Federal Rules of Civil Procedure, and because the complaint failed to adequately plead scienter under the Private Securities Litigation Reform Act of 1995.

In granting the motion, the district court criticized plaintiff for including in the complaint large excerpts of defendants' public statements with no indication of what particular statements within those excerpts plaintiff considered false and misleading. The court also found that plaintiff failed to allege how the statements of various confidential witnesses on which plaintiff relied amounted to scienter. The court allowed plaintiff one additional opportunity to amend the complaint, but cautioned that "if the complaint is again a chore to piece together, it will be dismissed with prejudice." (*Lifschitz v. Nextwave Wireless Inc., et al.*, 2011 WL 940918 (S.D. Cal. March 16, 2011))

## BANKING

### Address Change for FDIC's Consumer Response Center

Today the Federal Deposit Insurance Corporation (FDIC) announced a change in address for its Consumer Response Center (CRC) within the Division of Depositor and Consumer Protection. This address change requires all FDIC-supervised financial institutions to update certain consumer notices, as described below, as soon as practicable.

- Effective March 28, the CRC will have a new mailing address, as follows:  
FDIC  
Consumer Response Center  
1100 Walnut St., Box #11  
Kansas City, MO 64106
- To ensure the CRC receives consumer complaints promptly, FDIC-supervised institutions should update their Adverse Action Notice forms and Fair Housing posters to reflect the CRC's new mailing address as soon as practicable.
- Updated Fair Housing posters may be obtained at no cost from the FDIC's Public Information Center, 3501 Fairfax Drive, E-1014, Arlington, VA 22226 (877-275-3342 or 703-562-2200) or through FDICconnect.
- This change does not affect Community Reinvestment Act notices.
- This change is applicable only to FDIC-supervised institutions. Federally chartered banks, credit unions, and other institutions supervised by another federal bank regulatory agency are not affected by this change of address.

[Read more.](#)

### FDIC to Hold Open Meeting on March 29

The discussion agenda for the Federal Deposit Insurance Corporation's (FDIC's) open meeting includes:

- Notice of Proposed Rulemaking to Implement Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Credit Risk Retention)
- Resolution Plan and Credit Exposure Reports—Notice of Proposed Rulemaking

The meeting will be held in the board room on the sixth floor of the FDIC building located at 550 17th Street, N.W., Washington, D.C. This board meeting will be webcast live via the Internet and subsequently made available on demand approximately one week after the event.

Click [here](#) for more information and [here](#) to view the event.

### FDIC Staff Teleconference on Overdraft Payment Program Supervisory Guidance on March 29

Staff from the Federal Deposit Insurance Corporation's (FDIC's) Division of Depositor and Consumer Protection will host a teleconference on March 29 to discuss the 2010 Overdraft Payment Program Supervisory Guidance issued in November 2010 (FIL-81-2010). The purpose of the call is to assist FDIC-supervised institutions as they implement efforts to mitigate risk in response to the expectations and recommendations identified in the guidance. In addition to providing an overview of the guidance, staff will address examination and implementation issues based on discussions with, and questions received from, FDIC-supervised institutions.

- To allow sufficient time for institutions to review, consider and respond to the expectations in the final guidance, the FDIC stated that it expects any additional efforts to mitigate risk to be in place by July 1.
- The teleconference will be held on Tuesday, March 29, from 3:00 to 4:30 p.m. EDT.
- Advance registration is required. Registration information, presentation materials and call-in information will be made available [here](#).

[Read more.](#)

### FinCEN Updates Regulatory Forms and Citations

As part of the transfer of the Bank Secrecy Act regulations from 31 CFR Part 103 to 31 CFR Chapter X, the Financial Crimes Enforcement Network (FinCEN) has updated the regulatory citations found in its forms to 31 CFR Chapter X. There have been no substantive regulatory changes to the forms or the data elements requested through them as a result of this update of the regulatory citations. The updated forms are available for use [here](#). Please note that FinCEN will continue to accept and process older forms that contain citations to 31 CFR Part 103.

Click [here](#) to read more.

Click [here](#) for a list of updates to each form.

## UK DEVELOPMENTS

### UK Government Announces 2011 Budget, Tax Changes

On March 23, the UK Government announced its budget and tax proposals for the UK tax year April 2011–April 2012. Significant changes include:

- **Corporation Tax**—Corporation Tax, payable by UK tax resident companies and the UK branches of non-UK resident companies, is to be reduced to 26% from April 2011, and it will then drop by 1% each year to 23% from April 2014.
- **Double Tax Treaties**—New measures have been announced to combat the use of the UK's double tax treaties to avoid UK tax. These will target both UK residents (individuals, trustees and companies) who use tax avoidance schemes and overseas residents who claim benefits to which they should not be entitled under the UK double tax treaties. The Government will circulate draft legislation for comment in the fall with a view to passing legislation in 2012.
- **Bank Levy**—There will be increases in the UK bank levy payable by UK-based banks and the UK branches of overseas banks from January 1, 2012. The new rates will be 0.078% for short-term liabilities and 0.039% for long-term liabilities.
- **New Criteria for Investment Trust Companies**—An investment trust company is a widely held quoted company which operates as a UK-based retail investment fund in corporate form. Investment trust companies have traditionally been faced with strict limitations on what they can invest in and strict rules

mandating diversity of investment. The Government announced plans to liberalize these rules to allow investment trust companies to follow a wider range of investment practices.

- **Amendments to the Offshore Funds Rules**—The UK maintains rules which provide for a UK investor selling or redeeming its interest in an offshore fund to be taxed on income (at rates of up to 50%) instead of capital gains (at an 18% flat rate). An offshore fund can avoid these rules by becoming a "reporting fund," in which case any UK investors are taxed every year on any income of the fund (regardless of whether or not they have received it) but, in return, are only taxed on capital gains on a disposal of their units. At present, many offshore funds have found it difficult to become "reporting funds" because of issues over equalization arrangements and concerns as to whether frequent trading in certain investments constitutes income. The Government intends to introduce changes to the Offshore Fund Rules which, it claims, will deal with these issues.
- **Tax Transparent Funds**—The Government intends to introduce measures to create a type of UK tax transparent fund (i.e., no UK tax at fund level). The legislation will be introduced in 2012 and the Government will consult on this measure in June 2011.
- **Passport System for UCITS**—At present, there is a risk that a Luxembourg or Irish Undertaking for Collective Investment in Transferable Securities (UCITS) may be treated as being UK resident (and subject to UK tax at fund level) if it has a UK investment manager. The Government has announced that this will no longer be the case, so that a UCITS will not be resident in the UK for tax purposes if it is established and regulated in another European Economic Area state.
- **Non-Domiciled Persons Rules**—At present, individuals who are UK tax resident but domiciled overseas are obliged to pay UK tax only on UK-source income and capital gains unless they "remit" (broadly, bring in) the proceeds of any overseas income or capital gains into the UK. Individuals who have been resident in the UK for at least seven out of the last nine tax years are obliged to make an annual election for "non-dom" status and pay an annual flat fee of £30,000 (approximately \$48,000). The Government has announced that it will be consulting about increasing this annual flat fee to £50,000 (approximately \$64,000) for non-domiciled individuals who have been UK tax resident for 12 or more years. The Government will also consult about introducing a new statutory test of residence for individuals to replace the existing, highly ambiguous combination of case law and tax authority practice.
- **Controlled Foreign Companies (CFCs)**—These are, broadly, companies in low tax jurisdictions which are controlled by one or more UK companies. The present position allows the UK tax authorities to impute profits earned by CFCs back to their UK shareholders. The UK Government, as part of an initiative to prevent UK companies from moving out of the UK, has announced:
  - 1) An intention to fully reform the CFC rules so that, generally, the attribution rules will apply only to the profits of CFCs which have been artificially diverted elsewhere. There will be a partial exemption for finance companies, resulting in a charge of only one quarter of the full rate of UK corporation tax. By 2014, this will mean that the effective tax rate for these companies will be only 5.75%. The Government will consult on draft legislation in May 2011 to take effect in 2012.
  - 2) A series of interim reforms to include: an exemption for CFCs whose main business is patent exploitation where the intellectual property and CFC have little underlying connection to the UK, a three-year "holiday" from the rules for CFCs which only become UK CFCs because a foreign parent has been taken over by a UK group, and a de minimis exemption for profits below £200,000 (approximately \$322,000).
- **Foreign Branch Tax Exemption**—UK companies will not generally be taxable on the profits of foreign branches except where they make election to make these profits taxable. The election, once made, will be irrevocable.

[Read more.](#)

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