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Corporate and Financial Weekly Digest

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BROKER DEALER

FINRA to Require Firms to Designate a Super Account Administrator

On March 29, the Financial Industry Regulatory Authority will begin requiring firms to designate a Super Account Administrator (SAA) to create other account administrators and user accounts for firms and to manage firms' access to FINRA systems. With the implementation of the SAA, firms will use just one form for both the creation and modification of an SAA account instead of relying upon FINRA for the creation and maintenance of all account administrators. FINRA will implement the SAA role in phases through early 2011 and will notify firms via email of their SAA designation windows and provide instructions approximately six weeks prior to their designation due dates.

Click here to read the FINRA Information Notice.

CBOE and CHX Amend Rules to Prohibit Broker Discretionary Voting on Director Elections and Other Matters

On March 18, the Securities and Exchange Commission issued Releases No. 34-61732 and 34-61733 describing immediately effective changes to Chicago Board Options Exchange, Incorporated (CBOE) and Chicago Stock Exchange (CHX) rules regarding broker discretionary voting. In line with similar changes recently adopted by the New York Stock Exchange, under amended CBOE Rule 31.85, brokers may not vote on director elections (contested or not) at shareholder meetings without specific instructions from the beneficial owner, except with respect to companies registered under the Investment Company Act of 1940. As amended, CBOE Rule 31.85 also will preclude broker discretionary voting on matters that materially amend an investment advisory contract with an investment company.

Also to streamline with the NYSE, CHX has amended Article 8, Rule 14 regarding proxy voting by CHX participants who hold stock on behalf of a beneficial owner to enumerate certain matters that substantially affect the rights and privileges of stock and therefore should not be voted on by CHX participants without instructions from the beneficial owner.

Click here to read SEC Release 34-61732.
Click here to read SEC Release 34-61733.

CFTC

CFTC Denies Relief from Customer Account Identification Requirement at Time of Order Entry

The Division of Clearing and Intermediary Oversight (DCIO) of the Commodity Futures Trading Commission has denied a request from a registered introducing broker (IB) for relief from the requirement under CFTC Regulation 1.35(a-1)(1) that an IB provide its clearing futures commission merchant (FCM) with specific customer account identifiers at or prior to the time it places orders with its FCM.

Customers of the requesting IB had directed it to place trades on their behalf based on signals produced by third-party computer-based trading systems and alerts from third-party newsletters. The IB had requested relief on the grounds that, because of the frequency with which signals and alerts are generated and because of the disparate nature of the trade parameters provided by individual customers and the possibility of such parameters being changed by customers on short notice, it was unable to find a technically feasible means of providing its FCM with accurate allocations of bunched orders prior to or at the time of order entry without the risk of missing customer trades or of price "slippage" for those trades. The IB also argued that relief was justified because CFTC Regulation

1.35(a-1)(5)(i) allows certain "eligible account managers," including registered commodity trading advisors, to engage in post-trade allocation of bunched orders.

DCIO denied the request, noting that IBs were specifically excluded from the list of "eligible account managers" when CFTC Regulation 1.35(a-1)(5)(i) was adopted. IBs, therefore, are not eligible to provide customer account allocation information after a trade has been executed. DCIO further explained that the requesting IB was not required to operate under the business model that it had chosen and that the inconsistency of the IB's business model with CFTC requirements was not sufficient justification for exemption from the relevant regulation.

The no-action letter from the CFTC can be found here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Initiates Review on Use of Derivatives by Investment Companies

On March 25, the staff of the Securities and Exchange Commission issued a press release setting forth plans for the review of the use of derivative instruments by investment companies, including mutual funds and exchange-traded funds (ETFs). The review will seek to determine the sufficiency of and need for further investor protections under the Investment Company Act of 1940.

With respect to investment company use of derivatives, the staff intends to examine consistency with current leverage, concentration and diversification standards; risk management and compliance procedures; board standards for review of derivative strategies and counterparties; valuation procedures; prospectus disclosures; and reporting requirements.

Pending the review's completion, the SEC will defer consideration of requests for exemptive relief by investment companies that utilize derivatives in their principal investment strategies. Funds and ETFs which currently utilize derivatives in their trading activities under exemptive orders already granted by the SEC under the Investment Company Act will not be impacted at this time and may continue to issue additional shares.

Other exchange-traded vehicles that are not investment companies, such as exchange-traded commodities funds (ETCs), are not affected by this announcement because they are not subject to the provisions of the Investment Company Act and therefore do not apply for exemptive relief.

Click here to view the SEC press release described above.

LITIGATION

State Law Governs Determination of Whether Non-Signatory Can Be Compelled to Arbitrate

The Fifth Circuit Court of Appeals has reversed and remanded a ruling by a district court that an injured worker could not be compelled to arbitrate against his former employer's insurer.

Anthony Todd was injured while working for the Delta Queen Steamboat Company. When he was unable to recover against Delta Queen, which was insolvent, he brought a direct action against its insurer, Steamship Mutual Underwriting Association (Bermuda) Ltd. Steamship sought to stay the action, arguing that Mr. Todd should be compelled to arbitrate pursuant to a provision in Delta Queen's policy because he was a third-party beneficiary to that agreement, which was governed by federal law. The district court denied Steamship's request for a stay, however, relying on Fifth Circuit precedent holding that under applicable federal law, plaintiffs in direct actions against insurance companies could not be bound by arbitration clauses in agreements to which they were not a party.

The Fifth Circuit reversed the district court's ruling, however, holding that the Supreme Court decision in *Arthur Anderson LLP v. Carlisle*, 129 S. Ct. 1896 (2009), which was issued after the district court rendered its opinion, had overruled the Fifth Circuit precedent relied upon by the district court. The Court in *Carlisle* held that a court must look to state contract law principles, not federal law, in order to determine the scope of arbitration agreements, "including the question of who is to be bound by them." Thus, the Fifth Circuit remanded the case for further consideration under state law. (*Todd v. Steamship Mut. Underwriting Ass'n. (Bermuda) Ltd.*, No. 09-30177, 2010 WL 969795 (5th Cir. Mar. 18, 2010))

Federal Court Denies Preliminary Injunction to Enforce Restrictive Covenants

The U.S. District Court for the Eastern District of Wisconsin denied a company's request to temporarily enjoin its former employees from violating restrictive covenants by working for a competitor because the scope of the covenants was too broad and because the company waited too long to seek relief.

Four sales agents and four managers left Share Corporation, a chemical manufacturer, for rival Momar Inc., in the summer of 2009. In October 2009, Share sent "cease and desist" letters to the former employees, demanding that the employees immediately cease soliciting Share's employees and utilizing its confidential information. Dissatisfied with the response to those letters, Share filed a lawsuit against Momar and the former employees on February 9, 2010, and, three days later, moved for a temporary restraining order and preliminary injunction.

The district court denied the motion, holding that Share was unlikely to succeed on its claims because the restrictive covenants were too broadly drafted and thus unenforceable. In particular, the court held that a clause prohibiting an employee from soliciting customers in his "geographic region," without defining that region, was too broad to be enforced. Additionally, the court held that because Share had waited many months before filing its lawsuit, it could not demonstrate that it would be irreparably harmed if a preliminary injunction was not issued. (*Share Corp. v. Momar Inc.*, No. 10-CV-109, 2010 WL 933897 (E.D. Wis. Mar. 11, 2010))

EXECUTIVE COMPENSATION AND ERISA

Health Reform Legislation Affects Large and Small Employers

On March 23, President Obama signed into law the Patient Protection and Affordable Care Act (the Act), legislation that is likely to have a dramatic impact on health insurance in the United States as it is implemented over the coming months and years. The Act, as modified by the Health Care and Education Reconciliation Act of 2010—which was approved by Congress on March 25 and is expected to be signed by President Obama during the week of March 29—contains several provisions that have a direct effect on the manner in which employers provide health insurance benefits, as well as certain related tax obligations.

The following summarizes several key terms of the Act that affect how employers currently supply health coverage to their employees, as well as some notable provisions about how the employer-provided health insurance system may change in the future.

- <u>Changes to Exiting Plans for Next Year—</u>Starting with the first plan year that begins after September 23, 2010, employer-provided health plans must meet the following requirements:
  - *Coverage for Children until Age 26*. Plans must offer coverage to the adult child of an employee until the child reaches the age of 26. Until 2014, such coverage must be provided only if the adult child is unable to obtain coverage under a plan maintained by the child's employer (for example, because the child's employer does not provide such coverage) or another employer-sponsored plan.
  - *Lifetime Benefit Caps*. Plans are not permitted to include annual or lifetime limits on benefits. The application of this requirement will be based on future interpretive guidance from the Department of Health and Human Services.
  - *Auto-Enrollment for Large Employers*. Employers with 200 or more full-time employees must, subject to applicable waiting periods, automatically enroll new full-time employees in health coverage. Such new employees must be given relevant notices about coverage and must have the opportunity to opt out.
  - *Flexible Spending Account Changes*. Over-the-counter medications will no longer be eligible for reimbursement under flexible spending accounts, health savings accounts and other similar arrangements. In addition, effective in 2013, a new annual limit of $2,500 (as indexed in later years) on health flexible spending accounts will apply.
  - *Reporting Obligations*. The Act requires that employers report the aggregate cost of an employee's health coverage (medical, dental and vision) on that employee's annual Form W-2, beginning with the Form W-2 delivered during January 2012.
- <u>Key Changes with Later Effective Dates</u>
  - *Insurance Exchanges and Excise Taxes for Larger Employers*. Beginning in 2014, health insurance exchanges must be established in each state. The exchanges will provide various levels of coverage and pricing that ignore pre-existing conditions. These exchanges are expected to affect employers as follows:
    - The employees of smaller employers (generally those with fewer than 50 employees) would be eligible to purchase insurance within the exchange (and possibly with a federal subsidy) without penalty to the employer.

        - If a larger employer does not offer full-time employees affordable coverage, and such employees are forced to purchase insurance through the exchange, the employer may be subject to annual excise taxes which can reach as high as $3,000 per full-time employee.
    - *Pre-Existing Conditions and Waiting Periods*. Also beginning in 2014, employer health plans will be prohibited from including waiting periods in excess of 90 days and pre-existing condition exclusions.
    - *Reporting Obligations*. Starting in 2014, employers with 50 or more employees will be required to report whether they offer coverage to full-time employees, the length of applicable waiting periods, the cost of coverage, the employer's share of total costs, and the number and names of full-time employees receiving coverage.
    - *Excise Tax on "Cadillac Plans."* Beginning in 2018, certain high cost health insurance plans will be subject to a 40% excise tax on insurance companies (for policies sold in the group insurance market) and plan administrators (for self-funded plans). The tax would not apply to individual policies.

While the above is a list of some of the Act's key provisions that will affect employers, many other provisions will undoubtedly impact employers as the provisions of the Act become effective and the government issues regulations and other guidance.

The Patient Protection and Affordable Care Act can be found here.
The Reconciliation Act can be found here.

UK DEVELOPMENTS

Government Announces 2010/2011 Tax Proposals and Budget

The UK Government announced its proposed budget and tax proposals for the fiscal year 2010/2011 on March 24.

Most of the key changes, such as the new 50% rate of personal income tax on incomes over £150,000 (approximately $225,000) a year and certain changes to limit the application of the UK's Bank Payroll Tax had already been announced. However, the Government also announced:

- Its intention to consider establishing a new type of UK-domiciled tax-transparent investment fund.
- A review of the existing rules for investment trust companies.
- Certain amendments to the offshore funds rules. These rules mean that UK investors in offshore funds are charged income tax (at 50%) rather than capital gains tax (at 18%) on a redemption of units in an offshore fund unless the fund opts into a special regime of "tax-reporting" fund. This regime was already in place. The changes are extremely technical and are designed to avoid penalizing funds of funds which invest partly in non-tax reporting funds and partly in tax-reporting funds.
- Its intention to abolish Stamp Duty Reserve Tax (SDRT) on the acquisition of shares in UK-domiciled investment funds by other investment funds where the underlying fund is mainly invested in UK equities. Generally, SDRT is payable at the rate of 0.5% of the purchase price by the buyer of shares in any UK-domiciled fund (but not on a redemption of shares or units).
- An increase in stamp duty (real estate transfer tax) to 5% on the purchase of any residential property for more than £1 million (approximately $1.5 million).

Read more.

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