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Corporate and Financial Weekly Digest

March 30, 2007

SEC/Corporate

SEC Chairman Cox Expresses Views on CD&A Compliance

On March 23, Securities and Exchange Commission Chairman Christopher Cox spoke at the Second Annual USC Corporate Governance Summit regarding his views on issuer compliance with the narrative disclosure requirements of the Compensation Discussion and Analysis (CD&A) section now required in proxy statements. Chairman Cox expressed the strong view that CD&A disclosure is too long, insufficiently clear and "isn't anywhere close to plain English." He had hoped CD&A would in most cases be no more than a few pages long, but, according to an analysis of 40 companies' CD&A by investor relations firm Clarity Communications, the average length of CD&A disclosure was 5,472 words, "more than the U.S. Constitution", in Cox's words.

The Clarity Communications study used three "readability metrics" commonly applied to journalistic publications such as Reader's Digest and the Wall Street Journal. The first metric, the Gunning Fog Index, developed in 1952 to measure the readability of English prose, recommends that writing aimed at a general audience should have a Fog Index score of less than 12. The Wall Street Journal, with an educated general audience, scores just under 12; Reader's Digest, with a broader audience, scores approximately an 8. The average CD&A section scored 16.45, roughly equivalent to a Ph.D dissertation. The other metrics, the Flesch Reading Ease test and the Flesch-Kincaid readability algorithm, judged current CD&A disclosure to be similarly unreadable.

Historically, Chairman Cox noted, prospectus and proxy statement disclosure was shorter and less cumbersome, but has grown longer and more complex as lawyers, underwriters and companies grew more concerned with protecting against lawsuits and other liability than with readability. Cox notes this approach has left the average investor poorly served.

Chairman Cox closed his remarks on CD&A by stating the SEC was "dead serious about shedding 70 years of accumulated bad habits in writing." He did not comment on or disclose the Fox Index score of the SEC's 436-page release on the new executive compensation disclosure regulations which set forth the CD&A requirements.

www.securitiesmosaic.com/gateway/rules/SP.spch032307cc.032307.htm

SEC Schedules Open Meeting to Discuss PCAOB's Proposed Auditing Standard and Management Guidance for SOX 404

The Securities and Exchange Commission announced it will hold an open meeting on April 4, to discuss the Public Company Accounting Oversight Board's (PCAOB) proposed auditing standard for Section 404 of the

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Sarbanes-Oxley Act and the coordination of that proposed standard with the Commission's related pending proposal to provide guidance for management of public companies implementing Section 404. Both proposals were published for public comment in December 2006, and the comment period for both proposals ended on Feb. 26.

http://www.sec.gov/news/press/2007/2007-56.htm

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Portfolio Margin Risk Disclosure Statement NTM

The National Association of Securities Dealers has published a Notice to Members (NTM) 07-14 regarding a rule change the NASD recently filed with the Securities and Exchange Commission. The filing amends Rule 2520 (Margin Requirements) to permit members, on a pilot basis, to margin certain products according to a portfolio margin methodology. Furthermore, the NASD amended Rule 2860 (Options) to require members to furnish to their customers who use a portfolio margin account a disclosure statement and written acknowledgement for use with the proposed portfolio margin program.

The disclosure must be in a format prescribed by the NASD or developed by the member, provided that it contains substantially similar information as in the prescribed NASD format and has received the prior written approval of the NASD. Attachment A to the NTM 07-14 provides the language required to be included in the written disclosure statement and acknowledgement.

http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_018847.pdf

NYSE Proposes "Telephone Solicitations" Rule Change

The New York Stock Exchange LLC filed with the Securities and Exchange Commission proposed rule changes to NYSE Rule 440A, to address member organizations' telephone solicitations of customers. Rule 440A(g) provides that "No member or member organization may use a telephone facsimile machine, computer or other device to send an unsolicited advertisement to a telephone facsimile machine, computer or other device."

In addition to the existing exceptions contained in Rule 440A, the proposed amendment would provide that an advertisement would not be considered "unsolicited" where there is an "established business relationship" as defined in present Rule 440A(j). The proposed amendment also would set forth the measures necessary for a customer to opt out of the receipt of further communications from the member firm.

http://www.sec.gov/rules/sro/nyse/2007/34-55517.pdf

Proposed Rule Change Relating to Linkage Orders

Over the course of February and March of 2007, the American Stock Exchange LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Incorporated and the International Securities Exchange, Inc. (each, an Exchange and, collectively, the Exchanges), respectively, filed with the Securities and Exchange Commission proposed rule changes and amendments thereto pertaining to the Intermarket Options Linkage (Linkage) to conform such rules to Joint Amendment No. 22 of the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage.

The Exchanges propose to reduce the "turn-around" times in the Linkage to 5 seconds. Consequently, if a member of an Exchange does not receive a response to its linkage order (i.e., P/A Order and Principal Order) within 5 seconds, that member would be able to reject any response claiming to be an execution received thereafter. The member also would be able to trade through the Exchange that failed to respond within 5 seconds. Correspondingly, if a member of one Exchange responds to the Linkage Order more than 5 seconds after receiving that order, and the Exchange that sent the Linkage Order cancels such response, the member would be required to cancel any trade resulting from that order.

The SEC stated that reducing the time required by an Exchange to respond to a linkage order and reducing the amount of time a member sending a linkage order must wait before trading through a non-responsive Exchange should facilitate the more timely execution of orders across the Exchanges.

http://www.sec.gov/rules/sro/amex/2007/34-55539.pdf

Banking

FDIC Considers Micro-Loans

Federal Deposit Insurance Corporation (FDIC) staff, on March 28, outlined a proposal before the FDIC Advisory Committee on Economic Inclusion to create a two-year pilot project for banks. The committee endorsed the project to highlight the need for reasonably priced, small-dollar loan programs that provide value to consumers and banks.

"The FDIC, and its Chairman, Sheila Bair, should be proud of recent efforts that encourage banks to reach out and serve the growing ranks of the unbanked and underserved population in our country," said Diana L. Taylor, Chairman of the FDIC Advisory Committee on Economic Inclusion. "The committee strongly endorses this innovative pilot project and looks forward to assisting the FDIC and its Board of Directors in reviewing and implementing this program."

Some of the key features of the pilot project could include: loan amounts of up to $1,000; mandatory savings components; payment periods that extend beyond a single pay period; interest rates below 36 percent; low or no origination fees; no prepayment penalties; prompt loan application processing; and access to financial education to help with asset building. As an incentive, participating institutions could receive favorable consideration under the Community Reinvestment Act or be selected to serve as depositories for FDIC funds.

More details of the pilot project will be made available if the FDIC Board decides to consider the program. There is no timetable as to when the Board may act, but if it does, the proposal will be issued for comment before it becomes effective.

http://www.fdic.gov/news/news/press/2007/pr07026.html

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United Kingdom Developments

Terms of Reference for Private Equity Inquiry Announced

As part of its inquiry into private equity funds, the UK House of Commons Treasury Select Committee is undertaking work under the theme of “Transparency in Financial Markets and the Structure of UK Plc”. On March 20, the Treasury Committee announced the terms of reference for its inquiry and the Committee has invited evidence to be submitted on: (i) the regulatory

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environment; (ii) taxation; and (iii) the economic context of private equity.

The Committee invites written evidence on this inquiry by May 9.

http://www.parliament.uk/parliamentary_committees/treasury_committee/tc200307pn36.cfm

FSA Publishes Perimeter Guidance Relating to MiFID

On March 23, the UK Financial Services Authority (FSA) published policy statement PS07/5 "Perimeter Guidance relating to MiFID". This policy statement responds to comments on previous draft guidance relating to the scope of the EU Markets in Financial Instruments Directive (MiFID). The Perimeter Guidance sets out what activities and entities are within the scope of FSA regulation.

Issues discussed include the impact of MiFID on credit institutions, the relationship between the existing regime for authorized professional firms and the MiFID provisions, the regulatory status of forward foreign exchange contracts and the relationship between MiFID investment services and the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, the statutory instrument which sets out which activities are currently subject to FSA regulation.

The final guidance will take effect from November 1, the implementation date of MiFID.

http://www.fsa.gov.uk/pubs/policy/ps07_05.pdf

FSA Reviews UK Commodities Markets

The Financial Services Authority (FSA) published "Growth in Commodity Investment: Risks and Challenges for Commodity Market Participants" on March 26. This paper examines the recent increases of investment in and new products on UK commodity markets.

The FSA is reviewing possible risks that these may pose to maintaining confidence in the UK financial system including: (i) systems and controls on exchanges dealing with the increased volume of trades; (ii) risk management; (iii) challenges posed by high volume trading and new trading techniques; and (iv) unsuitability of investments for retail investors.

The FSA has announced that it will increase its monitoring of UK commodities markets and FSA regulated firms and exchanges are advised to put in place appropriate measures to detect and prevent improper practices.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/039.shtml

Widening the Market for Alternative Investment Vehicles

On March 27, the Financial Services Authority (FSA) published for consultation its proposals for alternative investment vehicles, including funds of hedge funds, which can be marketed to UK retail investors.

The FSA believes that the introduction of retail-oriented Funds of Alternative Investment Funds is appropriate as retail investors have been able to gain exposure to hedge funds and other alternative products via vehicles such as structured products. The FSA proposes to introduce substantial structural and operational safeguards including requirements to have an independent depositary, independent valuations and timely redemption of investments.

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The consultation closes on June 27.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/040.shtml

FSA Takes Bankruptcy Proceedings Against UK Lawyer

In proceedings commenced by the Financial Services Authority (FSA), the UK High Court ruled in December 2004 that Adrian Sam & Co (ASC) and John Martin, one of ASC's two partners, were knowingly involved in the UK activities of an illegal overseas investment firm (a boiler room) and they were ordered to pay £360,000 (approximately $700,000) to 63 investors involved in the boiler room scam. A bankruptcy order was granted against John Martin in August 2006.

On March 29, Adrian Sam, the second partner in ASC was also made bankrupt by the court on the FSA's application. The court found that the involvement of John Martin, Adrian Sam and ASC was an integral part of the illegal boiler room activity.

http://www.fsa.gov.uk/pages/Library/Communication/PR/2007/044.shtml

FSA Fines Analyst $102,000 for Selective Disclosure

On March 20, the Financial Services Authority (FSA) announced that it had fined Roberto Casoni, a former equities analyst with a major investment bank, £52,500 (approx $102,000) for failing to observe proper standards of market conduct while carrying out his role as an approved person – a breach of Principle 3 of the FSA's Statement of Principles for Approved Persons.

On January 9, 2006 Mr. Casoni began the approval process for his employer to initiate coverage of an Italian bank (BI). However prior to its publication, Mr. Casoni selectively disclosed details of his valuation methodology, final recommendation and the target price for BI. In one case he also told a client the expected date of publication. The research, which contained a buy recommendation with a target price of €39 per share was published when BI shares were trading at €25.70.

Mr. Casoni's employer brought the matter to the FSA's attention. The FSA took the view that by disclosing the information Mr. Casoni had failed to observe proper standards of market conduct. He gave the recipients the opportunity to pre-empt the conclusions of the published research ahead of the rest of the market. The fact that they did not do so was not relevant.

On the amount of the penalty, the FSA took into account the fact that Mr. Casoni did not have any intention of manipulating BI's share price and he did not make any personal financial gain from his conduct. Further he co-operated fully with the FSA and agreed to settle this matter at an early stage of the FSA proceedings. This entitled him to a 30% reduction in the amount of his fine, from £75,000 (approx $133,000) to £52,500 (approx $102,000). He has not previously been the subject of FSA disciplinary action.

http://www.fsa.gov.uk/pubs/final/casoni_20mar07.pdf

EU Developments

CESR Publishes Guidelines on UCITS Eligible Assets

On March 20, the Committee of European Securities Regulators (CESR) published guidelines on eligible assets under the Undertakings for the Collective Investment of Transferable Securities (UCITS) Directive. The

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guidelines complement the Level 2 implementing directive published by the European Commission on March 19 and clarify the instruments that can be held by funds established under the UCITS Directive for sale to retail investors under the UCITS Directive's cross-border passport.

http://www.cesr.eu/index.php?docid=4421

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Short-Swing Profits Claim Against "Non-Beneficial Owner" Dismissed

The U.S. District Court for the Southern District of New York granted summary judgment in favor of insider-defendants on the grounds that they were not beneficial owners under § 16(b) of the Securities Exchange Act. Section 16(b) provides for strict liability upon showing that there was [1] a purchase and a sale of securities [2] by an officer or director of the issuer or by a shareholder who owns more than 10 percent of any one class of the issuer's securities, [3] within a 6-month period. Disgorgement to the company of short-swing profits is required irrespective of intent or whether overall trading during that 6-month period resulted in a loss. However, an SEC-established "safe harbor" exempts a shareholder from being defined as a beneficial owner of shares of another entity if the shareholder (i) is not a controlling shareholder of such entity, and (ii) does not have or share investment control over the entity's portfolio.

The District Court held that the exemption applied to the insider-defendants because (i) their combined total holdings of 17.3% of the selling shareholder's stock did not establish the requisite control, *i.e.*, the power to exercise control over the corporation by virtue of their holdings; and (ii) they did not have or share investment control of the selling shareholder's portfolio. The Court noted that the one defendant who was a director of the selling shareholder specifically absented himself from the Board's vote authorizing the shareholder to sell stock, including the shares in issue in the lawsuit. (*Feder v. Frost,* No. 98 CIV. 4744(RO), 2007 WL 509433 (S.D.N.Y. Feb. 15, 2007))

Securities Exchange Act Claims Failed to Meet PSLRA Pleading Requirements

The U.S. District Court for the Southern District of New York dismissed a class action complaint asserting, among others, claims under Section 10(b) of the Securities Exchange Act and Rule 10b-5 arising from the defendants' allegedly false and misleading statements about its prospective earnings and problems with its travel-related businesses. With respect to the earnings projections, the Court found that because they were couched with "specific cautionary language" and accompanied by disclosures of various risk factors (including those most likely to cause actual results to vary from the projections), they were "inactionable" under the Private Securities Litigation Reform Act's safe harbor exception for forward-looking statements and the "bespeaks caution" doctrine.

With respect to the disclosures regarding the health of defendants' travel businesses, the Court ruled that plaintiffs failed to plead fraud with the particularity required by Fed.R.Civ.P. 9(b) and the PSLRA, which requires plaintiffs to demonstrate with specificity how and why allegedly false statements are fraudulent. For example, the Court found the Complaint to contain "no facts" to support the allegation that defendants affirmatively misrepresented the company's lack of long-term contracts with airlines.

Similarly, the Court found the allegations of "bad business practices" relating to the defendant company's relationships with its hotel suppliers – which allegations were based upon information attributed to anonymous former employees – to have been asserted "in the most general of terms" without any "names, dates, places or other information that might help the Court evaluate whether these employees were actually in a position to know" about the allegedly bad business practices. (*In re IAC/InterActiveCorp Securities Litigation,* No. 04 Civ. 7447 (RJH), 2007 WL 853021 (S.D.N.Y. Mar. 21, 2007))

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CFTC Grants TAIFEX-Designated Firms Exemption from Part 30 Rules

The Commodity Futures Trading Commission has granted an exemption, pursuant to CFTC Rule 30.10, to foreign firms designated by the Taiwan Futures Exchange (TAIFEX) from certain CFTC regulations which govern the offer and sale to U.S. persons of commodity futures and options traded on a foreign board of trade (the Part 30 Rules). The exemption from the Part 30 rules is based upon substituted compliance by the designated firms with TAIFEX regulations and applicable Taiwanese law and includes exemptions from certain CFTC rules regarding registration, recordkeeping, risk disclosure and financial requirements. Unlike other Rule 30.10 exemptions, the CFTC order does not authorize TAIFEX member firms to do business with U.S. customers on non-U.S. markets other than TAIFEX. To take advantage of the exemption, designated firms must file written representations with the National Futures Association as set out in the CFTC's order.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-1521.pdf

NYMEX/Dubai Seek CFTC Relief from Secured Amount Requirements

On March 23, the New York Mercantile Exchange (NYMEX) requested an order from the Commodity Futures Trading Commission that would permit NYMEX and registered futures commission merchants (FCMs) to hold in customer segregated accounts positions and funds related to NYMEX's clearing of futures and options on futures traded on or subject to the rules of the Dubai Mercantile Exchange Limited (DME). Under the requested order, NYMEX and FCMs would be allowed to "commingle" any customer secured (CFTC Rule 30.7) amounts held to support trading in DME contracts with U.S. customer segregated funds, subject to the rules applicable to such segregated funds. The request is based upon NYMEX's status as the clearing house to DME and the exclusive use of NYMEX clearing members (and registered FCMs) to clear DME customer transactions.

The CFTC seeks public comment regarding the NYMEX proposal.

http://www.cftc.gov/files/tm/tmnymex4drequestredme.pdf

CFTC Approves NFA Interpretive Notice Regarding FDM Supervision of Electronic Trading Systems

On March 28, the Commodity Futures Trading Commission approved the National Futures Association's proposed Interpretive Notice to its Compliance Rule 2-36(e), which sets out guidelines for the supervision of electronic trading systems by forex dealer members (FDMs). The Notice provides guidance to FDMs in creating required written procedures reasonably designed to protect customer information, to efficiently deliver customer orders and report executions, to establish appropriate credit and risk-management controls and to protect the integrity of trades. The Notice also sets out details regarding FDM recordkeeping obligations and related procedures, including the information that an FDM's electronic system should record and maintain.

http://www.cftc.gov/opa/adv07/opawa13-07.htm
http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=1688

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