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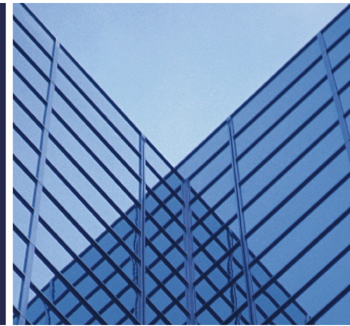
Corporate and Financial Weekly Digest



March 7, 2008

SEC/Corporate

SEC Announces Mid-Year Reduction to the Section 31 Fee Rate Effective April 1, 2008

On February 29, the Securities and Exchange Commission announced a reduction in the Section 31 fee rate. Section 31 of the Securities Exchange Act of 1934 (the Act) requires that self-regulatory organizations such as the NASD and all of the national securities exchanges pay transaction fees to the SEC based on the volume of securities that are sold on their markets. These fees cover the SEC's costs for supervising and regulating the securities markets and securities professionals.

The rate reduction will be effective April 1, and will reduce the fiscal year 2008 Section 31 fee rate by nearly 50 percent from the current rate of $11.00 per million to a revised rate of $5.60 per million.

The rate reduction is required in accordance with Section 31(j) of the Act, which requires the SEC to make annual and, in some cases, mid-year adjustments to the fee rate. These adjustments are necessary to ensure that the SEC's total collection of transaction fees in a given year are as close as possible to the amount set for that year pursuant to Section 31. The SEC is required to adjust the Section 31 fee rate if the baseline estimate of the aggregate dollar volume of sales for the fiscal year are reasonably likely to be 10 percent (or more) greater or less than the actual aggregate dollar volume of sales for such fiscal year.

The rate change will not apply to the Section 31 assessment on security futures transactions, which will remain at the rate of $0.0042 per round turn transaction.

http://www.sec.gov/rules/other/2008/34-57407.pdf

Broker Dealer

FinCEN Issues Guidance Regarding AML Responsibilities of Securities Clearing Firms

The Financial Crimes Enforcement Network (FinCEN) has issued a notice to clarify its position regarding the customer identification program rule (CIP rule) obligations of securities clearing firms in circumstances where account opening and order taking responsibilities are exclusively allocated to an introducing firm under a fully disclosed clearing agreement. Under these circumstances, FinCEN explained that it would take no action against a clearing firm for not complying with the CIP rule in order to promote consistency with the application of the CIP rules to intermediated relationships in other industries. The no-action position does not affect a clearing firm's obligation to implement

SEC/CORPORATE

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risk-based policies and procedures for assessing the money laundering risk posed by its fully disclosed clearing arrangements and for detecting and reporting suspicious activity.

http://www.fincen.gov/fin-2008-g002.html

FINRA Increases Margin Requirements for Auction Rate Securities

The Financial Industry Regulatory Authority, Inc. (FINRA) is temporarily increasing the maintenance margin requirements for auction rate securities pursuant to NYSE Rule 431(f)(8)(A) and NASD Rule 2520(f)(8)(A). All auction rate securities that are backed by fixed income products (e.g., municipal bonds, collateralized debt obligations, etc.) will have a 25% maintenance requirement effective immediately. The changes were in response to recent events in the marketplace, including failed auctions and illiquidity. The FINRA notice announcing the changes also warned firms "to give careful consideration to the classification of these securities on customer statements as cash or cash equivalents" and encouraged them to "review any references and characterization of these securities on member firms' Web sites as short term securities."

http://www.finra.org/web/groups/rules_regs/documents/notice_to_members/p038097.pdf

Amendments to CBOE Market-Maker and Remote Market-Maker Rules

The Chicago Board Options Exchange (CBOE) is proposing to amend its rules relating to Market-Makers and Remote Market-Makers (RMMs) by eliminating the RMM category. The category was established in 2005 to allow market participants to stream electronic quotations from outside of the physical trading station for an option class. At the time, Market-Makers were restricted from submitting electronic quotations from a location outside of the physical trading station but, over time, the CBOE has amended its rules to permit Market-Makers to submit electronic quotations from off the trading floor. While on the floor, a Market-Maker is not required to be in the trading station where a class is located in order to stream electronic quotations. As a result, the obligations of Market-Makers and RMMs are now generally the same and there is no reason to maintain the RMM category.

The CBOE is proposing to amend the definition of Market-Maker to include member organizations. The CBOE also proposes to amend its rules to allow any member organization that is the owner or lessee of more than one membership to designate one individual to be the nominee for all memberships utilized by the organization. However, for each membership utilized for trading in open outcry on the trading floor, the organization must designate a different individual to be the nominee for each of the memberships. The CBOE also proposes to update and amend its rules pertaining to the appointment of Market-Makers to (i) provide that appointments can be selected by Market-Makers or made by CBOE, (ii) delete the requirement that a Market-Maker may hold an appointment in an appropriate number of Hybrid option classes that are located at one trading station, and (iii) extend for an additional year the pilot programs set forth in CBOE Rule 8.3.

http://www.sec.gov/rules/sro/cboe/2008/34-57367.pdf

FINRA to Make Permanent Pilot Program Relating to Options Position and Exercise Limits

The Financial Industry Regulatory Authority, Inc. (FINRA) filed with the Securities and Exchange Commission proposed amendments to Rule 2860 (Options) to make permanent a pilot program that increases options position

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and exercise limits. In addition, FINRA proposes to amend NASD IM-2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the proposed permanent position limits. The proposed rule change is substantively identical to a proposal by the Chicago Board Options Exchange recently approved by the SEC.

http://www.sec.gov/rules/sro/finra/2008/34-57413.pdf

Investment Companies and Investment Advisors

Proposed Rules to Streamline ETF Approvals

On March 4, the Securities and Exchange Commission announced two new rule proposals under the Investment Company Act that would permit exchange traded funds (ETFs) to operate without their issuer's need to seek individual exemptive orders from the Commission. The finalization of these rules will also alleviate the pressure on Commission staff, who are currently required to review each exemptive order application from all issuers seeking to create an ETF Trust, and to reduce the months-long wait for review and comment that hinders the prospective issuers' launches.

Proposed Rule 6c-11 would codify most of the standard exemptions granted with reference to index-based ETFs and certain provisions of the exemptions recently granted for fully transparent actively-managed ETFs. Proposed Rule 12d1-4 would increase the amounts of ETF investments investment companies may make under the Investment Company Act. In addition, Form N-1A would be amended to include information specific to ETF sponsors and issuers. The proposed rules and form amendments are expected to be published soon for public comment.

http://sec.gov/news/press/2008/2008-30.htm

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Banking

Fed General Counsel Discusses Legal Standards for Approval of Sovereign Wealth Funds

On March 5, Scott Alvarez, General Counsel of the Board of Governors of the Federal Reserve System, testified before the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, and the Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Committee on Financial Services, U.S. House of Representatives. Mr. Alvarez' remarks were intended to inform members of the subcommittees of the legal standards that the Board of Governors uses to assess investments by sovereign wealth funds in bank holding companies.

http://www.federalreserve.gov/newsevents/testimony/alvarez20080305a.htm

OTS Issues Legal Opinion Confirming Preemptive Effect of Federal Law Over State Law in the Predatory Lending Area

Deputy Director and Chief Counsel John Bowman of the Office of Thrift Supervision (OTS), the agency that supervises the affairs of federally chartered savings associations, recently issued a brief legal opinion addressed to Standard & Poor's that confirms the agency's long held position that federal law and OTS regulations preempt state law. Addressing the predatory lending area specifically, the opinion states the agency's opinion that its regulations in the area "occupy the field."

http://www.ots.treas.gov/docs/5/560409.pdf

BANKING

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OCC Requests Monthly Mortgage Data From Large National Banks

On February 29, the Office of the Comptroller of the Currency (OCC) announced that it would require large national banks that service mortgages to provide on a monthly basis comprehensive mortgage data on all mortgages held by national banks and their subsidiaries and loans serviced for others. The intention is to build upon the efforts of the HOPE NOW alliance, a cooperative effort between investors, lenders and counselors, to help homeowners in danger of being foreclosed.

The letter making this request was sent to nine large national banks that "account for the overwhelming majority of national bank mortgage servicing." According to the OCC release, the "data is expected to give the OCC and other regulators a more complete view of the market, which will aid in the agency's supervisory work as well as help in preventing unnecessary foreclosures."

National banks receiving the letter must provide by March 31, 2008, aggregate month-end mortgage data on a best efforts basis for October 2007, November 2007, December 2007, January 2008, and February 2008 in accordance with OCC metrics, data definitions, and reporting schedules.
The release stated that the OCC is going to request similar data on home equity loans later this year.

http://www.occ.treas.gov/ftp/release/2008-24.htm

United Kingdom Developments

UK DEVELOPMENTS

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FSA Announces Final Rules on Telephone Taping

On March 3, the UK Financial Services Authority (FSA) published new rules requiring firms to record telephone conversations and other electronic communications. The FSA's stated purpose for introducing these requirements is the deterrence and detection of market abuse.

The rules, which will be effective from March 2009, will require FSA authorized firms to record all telephone conversations and electronic communications relating to client orders and the conclusion of transactions in the equity, bond, and derivatives markets. There are certain exemptions for discretionary investment managers and for electronic communications with firms that are subject to the FSA's taping rules.

The required retention period for recorded phone calls and electronic communications is 6 months.

When the FSA first consulted on taping rules in 2007 the proposed required retention period was 3 years and it was proposed to require mobile phone (cellphone) conversations to be recorded. Mobile phone conversations have been exempted from the taping rules, subject to review in 18 months' time.

www.fsa.gov.uk/pubs/policy/ps08_01.pdf

FSA Consultation on Listed Company Sponsor Regime

On March 6, the UK Financial Services Authority (FSA) published consultation paper CP08/5 *Sponsor regime – a targeted review* with proposed amendments to the sponsor regime for UK listed companies.

UK companies with what are called "primary" listed equity securities or new applicants seeking a primary listing are required to appoint a sponsor.

Sponsors generally include investment banks and corporate finance firms with specialist knowledge of the UK Listing Rules and the London equity market.

The consultation sets out several key proposals which include clarifying the application of the principles for sponsors set out at Chapter 8 of the UK Listing Rules, introducing procedures for identifying and managing conflicts within sponsors and revising FSA guidance on appropriate systems and controls for sponsors.

The consultation closes June 6.

www.fsa.gov.uk/pubs/cp/cp08_05.pdf

FSA Publishes Final Covered Bonds Rules

On March 6, the UK Financial Services Authority (FSA) published policy statement PS08/2 *Regulated Cover Bonds* with feedback on proposals for a UK recognized covered bonds regime together with final rule changes for the FSA's handbook including registration and ongoing requirements.

The policy statement follows a joint consultation with the UK Treasury launched in July 2007 that proposed the implementation of a UK recognized covered bonds legislative framework, as described in the July 27, 2007 edition of *Corporate and Financial Weekly Digest*.

The UK legislative framework under which UK issuers can issue covered bonds, which are permitted investments under Article 22(4) of the EU Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, also came into effect on March 6, as described in the November 16, 2007 edition of *Corporate and Financial Weekly Digest*.

www.fsa.gov.uk/pubs/policy/ps08_02.pdf

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Arbitration Clause in One Agreement Governed Dispute Under Related Agreement

Plaintiff sued defendants for, among other things, securities fraud in connection with its purchase of an unregistered security in one of the defendant limited liability companies (LLC). Despite representing in the Subscription Agreement that he was an "accredited investor," the plaintiff alleged that, in fact, he was not an "accredited investor" and, accordingly, the LLC was not exempt from the registration requirements of the Securities Act of 1933.

The Defendants moved to dismiss on multiple grounds, including that the dispute was governed by the arbitration clause in the LLC's Operating Agreement. Plaintiff opposed, arguing that the Subscription Agreement did not contain an arbitration clause and that the arbitration clause in the Operating Agreement was narrow in scope, concerned disputes over the operation and management of the LLC, and did not apply to his securities law claim.

After noting that federal policy and Delaware law, the governing law under the Operating Agreement, strongly favor arbitration when there is any doubt concerning the scope of arbitrable issues, the Court held that plaintiff's claim must be arbitrated. The Court characterized both the Operating Agreement and the Subscription Agreement, which were simultaneously executed, as "necessary to complete the [same] transaction" because the Operating Agreement governed the relationship of parties who purchased interests in the LLC through their execution of the Subscription Agreement. Because of their

"related" nature, the Court ruled that even though there was no arbitration clause in the Subscription Agreement, the arbitration clause in the Operating Agreement was sufficiently broad to "embrace" plaintiff's claims relating to the Subscription Agreement. (*Cohen v. Looking for Palladin, LLC, et al.,* 2008 WL 544597 (S.D.N.Y. Feb. 29, 2008))

Securities Complaint Satisfied Heightened PSLRA Pleading Standards

A federal district court denied a motion to dismiss claims under Section 10(b) of the Securities and Exchange Act of 1934 and Rule 10b-5. Plaintiffs alleged that defendants, acting as stock brokers and investment counselors, solicited and received funds from the plaintiffs which the defendants represented would be invested so that plaintiffs received a guaranteed investment return. Plaintiffs alleged, among other things, that defendants did not inform the plaintiffs of the potential risks of the investments and made other material misrepresentations and omissions in order to induce plaintiffs to invest. Ultimately, plaintiffs lost virtually their entire investment – including their retirement assets and proceeds from the sale of a house.

The Court disagreed with defendant's contention that plaintiffs failed to meet the pleading burdens established under the Private Securities Litigation Reform Act (PSLRA). After noting that the PSLRA's enhanced pleading standards only applied to the material misrepresentation and scienter elements of plaintiffs' securities claim, and not the reliance and causation elements, the Court held that plaintiffs had met their pleading burden. Without any detailed analysis, the Court concluded that the plaintiffs: (i) specifically alleged instances where the defendants made misrepresentations or omissions and identified how each was misleading; (ii) alleged throughout the complaint that the defendants made representations with reckless disregard for the truth and with the knowledge that their actions were misleading plaintiffs; (iii) justifiably relied on the defendants' material omissions or misstatements because, among other things, plaintiffs were unsophisticated investors who had a long standing business relationship with the defendants; and (iv) alleged that as a direct and proximate result of the defendants' actions, plaintiffs suffered a variety of economic losses. (*May, et al. v. Peninger, et al.*. 2008 WL 509470 (D.S.C. Feb. 22, 2008))

CFTC

CFTC Approves ICE-OCC Cross-Margining Program

The Commodity Futures Trading Commission has issued an order approving a non-proprietary cross-margining program between ICE Clear US, Inc. (ICE Clear) and The Options Clearing Corporation (OCC). Under the program, which is similar to the one in place between the Chicago Mercantile Exchange and the OCC, "Market Professionals" – *i.e.*, market makers, specialists or registered traders as defined by the OCC – that clear through participating firms that are members of ICE Clear and OCC will be permitted to cross-margin their positions in futures and options based on Russell Indexes.

http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5463-08.html

https://www.theice.com/clearing_cross_margin.jhtml

NFA Proposes Enhanced Disclosure Requirements for Forex Pools and Trading Advisors

The National Futures Association (NFA) has proposed the adoption of two new compliance rules intended to enhance and standardize disclosure and reporting obligations for commodity trading advisors (CTAs) and commodity pool operators (CPOs) that engage in over-the-counter (OTC) forex

CFTC

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transactions. Currently, registered CTAs and CPOs that trade OTC forex exclusively are not required to prepare and file disclosure documents or to comply with certain other disclosure requirements applicable to CTAs and CPOs that trade exchange-listed products. The proposed rules would require CTAs and CPOs that engage in OTC forex transactions on behalf of clients or pools that are not eligible contract participants to prepare a disclosure document in accordance with the requirements of CFTC Rules 4.24 – 4.26 (for CPOs) or 4.34 – 4.36 (for CTAs). The disclosure document would be required to be filed with NFA prior to its first use and provided to prospective clients or pool participants. In addition, the proposed rules would prescribe a specific risk disclosure statement regarding OTC forex trading to be included in the disclosure document (even if the CTA or pool also trades exchange-traded futures). The proposed rules appear to be applicable to registered CPOs and CTAs, including CPOs and CTAs that claim an exemption from preparing a disclosure document under the Commodity Futures Trading Commission Rule 4.7.

NFA's proposed rules also impose certain financial reporting requirements on CPOs subject to the rule, requiring them to provide pool participants with monthly or quarterly account statements, as well as an annual report.

http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=2101

NFA Clarifies Acceptable Collateral for Forex Security Deposits

The National Futures Association (NFA) has proposed amendments to Section 12 of its Financial Requirements to clarify the types of collateral that are acceptable as security deposits for over-the-counter forex transactions. The proposed amendments provide that, in addition to cash, NFA Forex Dealer Members may accept as collateral instruments described as "permitted investments" of customer segregated funds under the Commodity Futures Trading Commission Rule 1.25. Such instruments include U.S. Treasury securities, municipal bonds, commercial paper and certain foreign and corporate debt, among others. The collateral will be subject to the haircuts set forth in CFTC Rule 1.17.

http://www.nfa.futures.org/news/newsRuleSubLetter.asp?ArticleID=2095

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