CORPORATE & FINANCIAL

WEEKLY DIGEST

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SEC/CORPORATE

SEC Chairman Shapiro Remarks on Capital-Raising Reform

In testimony before the U.S. House of Representatives Committee on Oversight and Government Reform on May 10, Securities and Exchange Commission Chairman Mary Shapiro stated that she had instructed the staff of the SEC to "take a fresh look" at rules relating to public and private offerings of securities in light of advances in technology, accelerated communications and changes in the operations of the financial markets, with a view to encouraging capital formation. No timetable was provided. Specific areas of focus outlined by Chairman Shapiro include:

- the restrictions on communications in initial public offerings;
- whether the ban on general solicitation or advertising for private placements should be revised;
- the number of shareholders that trigger public reporting, including questions surrounding the use of special purpose vehicles that hold securities of a private company for groups of investors; and
- regulatory questions posed by new capital-raising strategies.

The SEC has for some time been considering modifying the general solicitation or advertising ban in connection with private placements and had, in 2007, proposed lessening of that prohibition for "large accredited investors." While the SEC has not adopted such a rule, many commentators noted that the general solicitation or advertising ban, in light of current communication technologies, has become anachronistic. Further, the recent Facebook private placement has raised questions concerning both the number of investors triggering public reporting requirements (currently 500) and whether, as is currently the case, only shares "held of record" count for such purposes.

Read more.

BROKER DEALER

FINRA Delays Implementation Date of Expansion of OATS to All NMS Stocks

The Financial Industry Regulatory Authority has delayed the implementation of the new Order Audit Trail System (OATS) recording and reporting requirements for national market system (NMS) stocks to October 3. FINRA was originally slated to begin phasing in the expansion on July 11. According to the Securities and Exchange Commission, FINRA is delaying the implementation date in an effort to give its members sufficient time to make necessary changes to their systems to enable them to comply with the expanded OATS recording and reporting requirements.

Click here to read Securities and Exchange Commission Release No. 34-64369.
Click here for information on previous guidance from FINRA regarding the expansion of OATS to all NMS stocks, as reported in the January 14 edition of *Corporate and Financial Weekly Digest*.

PRIVATE INVESTMENT FUNDS

Please see "Form SLT Revised and First Form SLT Filing Date Delayed" in **Investment Companies and Investment Advisers** below.

CFTC

Mark Wetjen Nominated to CFTC

On May 11, the White House announced that Mark Wetjen has been nominated to be Commissioner of the Commodity Futures Trading Commission. Mr. Wetjen is currently Counsel and Senior Policy Advisor to Nevada Senator and Senate Majority Leader Harry Reid.

The press release announcing Mr. Wetjen's nomination is available here.

INVESTMENT COMPANIES AND INVESTMENT ADVISERS

SEC Proposes Adjustments to Advisers Act "Qualified Client" Standard

The Securities and Exchange Commission has proposed amendments to Rule 205-3 under the Investment Advisers Act of 1940, as amended (the Advisers Act), to revise the definition of "qualified client." Under Rule 205-3, accounts of qualified clients are exempted from the Advisers Act's general prohibition against SEC-registered investment advisers charging performance-based fees to their advisory clients. Currently, a qualified client generally includes any client that has either (1) $750,000 or more under management with the investment adviser or (2) a net worth of at least $1.5 million.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC is required to adjust the dollar amount tests set forth in certain of its rules, including the qualified client definition, for inflation. Under the SEC's proposal, the qualified client definition would be revised to increase the "assets under management" threshold described above from $750,000 to $1 million and the "net worth" threshold from $1.5 million to $2 million. In addition, the revised definition would exclude the value of a natural person's primary residence (and associated secured indebtedness) for purposes of the net worth threshold. The SEC proposal would require the SEC to make similar inflation adjustments every five years.

Finally, the SEC's proposal includes new transition rules which would have the effect of "grandfathering" many existing performance-based fee arrangements. Specifically, increases in the "qualified client" dollar amount thresholds (including future inflation adjustments) would not apply retroactively to an investment adviser's clients (including investors in private funds managed by the investment adviser) whose performance-based fee arrangements were permissible under the law in effect at the time of entering into the advisory contract, even if the client subsequently invests additional funds with the adviser. In addition, for advisers that were previously exempt from SEC registration pursuant to Section 203 of the Advisers Act and subsequently register with the SEC, the restrictions on performance-based compensation would not apply to existing clients or private fund investors whose advisory contracts were entered into while the adviser was exempt from SEC registration, but would apply to new clients and investors.

The comment period for the SEC proposal closes on July 11.

A copy of the proposal is available here.

Form SLT Revised and First Form SLT Filing Date Delayed

The U.S. Department of the Treasury has published a revised version of, and has delayed the first required filing of, the monthly report to the Federal Reserve Bank relating to the aggregate holdings of long-term securities by U.S. and foreign residents (Form SLT). Investment advisers and/or private investment funds that exceed the $1 billion threshold described below must file their first Form SLT report no later than October 23.

Form SLT is designed to gather information on long-term U.S. securities held by foreign residents and long-term foreign securities held by U.S. residents. U.S.-resident issuers (including U.S. private funds) must report on Form SLT all securities they issue to foreign residents that are not held by U.S.-resident custodians (who have their own Form SLT reporting obligations), and U.S.-resident investors (including U.S. private funds) must report on Form SLT all of their investments in foreign securities that are not held by U.S.-resident custodians (who, again, have their own Form SLT reporting obligations). Investment advisers and managers should file one consolidated report of the holdings and issuances of all U.S.-resident parts of its own organization and of all U.S.-resident entities that they advise/manage. A Form SLT need not be filed unless the consolidated total of all reportable long-term U.S. and foreign securities equals or exceeds $1 billion.

The first Form SLT report will be due for the quarter ending September 30, 2011 (the first report was previously scheduled to be due for the quarter ending June 30, 2011). The second Form SLT report will be due for the quarter ending December 31, 2011. Thereafter, reporting will change to a monthly basis beginning with the report as of January 31, 2012. The Form SLT report must be submitted to the Federal Reserve Bank no later than the 23rd calendar day of the month following the report as-of date.

For a copy of Form SLT, see here.
For the Form SLT instructions, see here.

LITIGATION

Whistleblower Must Provide Information to the SEC to State a Retaliation Claim Under Dodd-Frank

A New York federal district court recently ruled that, with limited statutorily defined exceptions, a whistleblower asserting private relation claims under the Dodd-Frank Wall Street Reform and Consumer Protection Act must allege that the information he provided was reported to the Securities and Exchange Commission. The court held, however, that the Dodd-Frank Act does not require that the whistleblower directly provide the information to the SEC in order to pursue a claim. Rather, all that is required is that the whistleblower allege that he acted jointly in an effort to provide the information concerning the alleged misconduct to the SEC.

Patrick Egan was a salesman at TradingScreen, Inc., a privately held investment services firm, when he discovered that its chief executive officer was diverting company assets to other entities. Mr. Egan reported the wrongdoing to the company president, who in turn notified the board of directors, and an internal investigation led by a law firm confirmed his allegations. However, the CEO managed to gain control of the board of directors, avoiding termination, and fired Mr. Egan. Mr. Egan sued, seeking relief on various grounds including under the Dodd-Frank Act's provisions permitting a whistleblower who reports securities violations to assert a private right of action if he is retaliated against for providing the information.

Defendants moved to dismiss, arguing, among other things, that the Dodd-Frank Act requires whistleblowers to provide the information to the SEC directly in order to pursue a private right of action. In opposing the motion, Mr. Egan argued that the retaliation provisions did not require that he report the information to the SEC and that, in any event, he had satisfied the requirement by reporting the wrongdoing and cooperating in the internal investigation. Mr. Egan also argued that his disclosures fell under one of several provisions that explicitly did not require disclosure to the SEC.

The U.S. District Court for the Southern District of New York held, as a matter of first impression, that, with the exception of four statutorily defined categories of disclosures, to pursue a retaliation claim, a whistleblower must allege that they provided information to the SEC. In so holding, the court pointed out that an examination of the statutory language indicates that Congress "intended to encourage whistleblowers reporting such [securities] violations to report to the SEC." The court also held that Mr. Egan's disclosures did not fall under any of the four categories of disclosures that do not require that the information be reported to the SEC.

However, the court also ruled that it was not necessary for Mr. Egan to allege that he had provided the information to the SEC directly; allegations that the information was provided jointly with the law firm conducting the internal investigation were sufficient. Although Mr. Egan had adequately alleged that he acted jointly with the law firm that conducted the internal investigation, his complaint did not set forth sufficient facts to support his allegation, upon information and belief, that the law firm actually provided the information to the SEC. Because it appeared during oral argument that Mr. Egan may be able to provide sufficient facts to support his allegation that the information he disclosed was provided to the SEC, the court granted him leave to amend his complaint. (*Egan v. TradingScreen, Inc.,* No. 10 Civ. 8202(LBS)., 2011 WL 1672066 (S.D.N.Y. May 4, 2011))

Failure to Issue Written Litigation Hold Did Not Warrant Sanctions

A company's failure to implement a written litigation hold and its subsequent failure to produce certain documents responsive to an adversary's discovery request did not require finding the company liable for spoliation of evidence, a New York federal court recently ruled.

Steuben Foods, Inc. sued Country Gourmet Foods, LLC, and Campbell Soup Company, asserting claims for breach of contract and various torts. At the time it first anticipated litigation, Steuben did not issue a written litigation hold requiring documents to be retained, but instead relied on oral directions to employees to instruct them to retain relevant documents. During the course of the litigation, Campbell served document requests and obtained—from sources other than Steuben—relevant documents that Steuben had possessed but did not produce. Campbell sought sanctions, arguing that Steuben was liable for spoliation of evidence for failing to issue a timely written litigation hold letter requiring all relevant documents to be retained and preserved.

The U.S. District Court for the Western District of New York disagreed, finding that there was no evidence that Steuben destroyed relevant documents and that the relevant documents were not sufficiently critical to Campbell's defense. Refusing to follow Judge Scheindlin's finding in *Pension Committee v. Banc of America Securities, LLC* that the failure to issue a written litigation hold constituted gross negligence, the court held that a party's failure to implement a written litigation hold, by itself, did not give rise to a rebuttable presumption of spoliation. In particular, the court distinguished *Pension Committee* on the grounds that the "paucity" of documents produced in that case led to the conclusion that documents must have been lost or destroyed. Moreover, the court noted that oral instructions to preserve documents may be more appropriate in relatively smaller companies, such as Steuben, which only had 400 employees. (*Steuben Foods, Inc. v. Country Gourmet Foods, LLC,* No. 08–CV–561S(F), 2011 WL 1549450 (W.D.N.Y. April 21, 2011))

BANKING

Comptroller of the Currency Revises Servicemembers Civil Relief Act Exam Procedures

On May 3, the Office of the Comptroller of the Currency (OCC) issued revised examination procedures for the Servicemembers Civil Relief Act of 2003 (SCRA). The SCRA provides certain financial protections to service members and, in some cases, their spouses, dependents and other persons subject to the obligation of service members. These financial protections include restrictions on interest rates, contract rescissions, foreclosures and exercise of certain insurance policy options. The SCRA also has implications on adverse actions such as reports by or to a consumer-reporting agency that relate to the creditworthiness of the service member. Recent amendments to the Housing and Economic Recovery Act of 2008 extended the time period for certain protections in the SCRA. In particular, the provision for an extended time period for protections affecting foreclosure, sale or seizure of real or personal property remains effective through December 31, 2012.

These revised procedures replace the SCRA procedures that were included in the "Other Consumer Protection Laws and Regulations" booklet of the *Comptroller's Handbook*.

Read more.

Comptroller of the Currency Revises Protecting Tenants at Foreclosure Act Exam Procedures

On May 3, the Office of the Comptroller of the Currency (OCC) issued revised examination procedures for the Protecting Tenants at Foreclosure Act (Tenants Protection Act). The Tenants Protection Act, which is part of the Helping Families Save Their Homes Act of 2009, became effective on May 20, 2009. The Tenants Protection Act provides protections to *bona fide* tenants in the case of any foreclosure on a federally related mortgage loan or on any dwelling or residential real property. These protections provide that any immediate successor in interest in such a foreclosed property, including a bank that takes title to a house after foreclosure, will assume the interest subject to the rights of any *bona fide* tenant and must comply with certain notice requirements.

The Dodd-Frank Wall Street Reform and Consumer Protection Act revised the Tenants Protection Act by adding a definition for the date of a notice of foreclosure and by extending its expiration date to December 31, 2014.

These revised procedures replace the Tenants Protection Act procedures that were distributed via OCC Bulletin 2010-2, which this issuance rescinds.

Read more.

Comptroller of the Currency Issues Incident Prevention and Information Security Alert to National Banks

On April 18, the Office of the Comptroller of the Currency (OCC) issued an alert to CEOs of National Banks and other regulated entities. The alert highlights the need for national banks and their technology service providers (TSPs) to take steps to ensure their enterprise risk management is sufficiently robust to protect and secure the bank's own and their customers' information. The OCC explained that several recent security breaches have highlighted the need for national banks and their TSPs to perform periodic risk assessments of their information security programs with respect to the prevention and detection of security incidents. Most security-related incidents occur because of the lack or failures of basic controls that allow attackers to gain entry into a target environment through phishing, spear-phishing, drive-by malware injection and other techniques. Once attackers have entered an environment, they typically use sophisticated tools and techniques to gain access to sensitive data or systems. Successful attacks often compromise sensitive customer information or create fraud. The increasing sophistication of the tools and techniques attackers use often includes stealth or other means that make their detection more difficult.

The OCC stated that it expects national banks and their TSPs to review carefully the National Security Agency's (NSA's) Information Assurance Advisory (March 28) and the United States Computer Emergency Readiness Team's (US-CERT) Early Warning and Indicator Notice (EWIN) 11-077-01A Update, both associated with one of the recent events. The NSA advisory provides detailed recommendations consistent with previously issued OCC and Federal Financial Institution Examination Council guidance. Access to sensitive information, systems and control components should be highly restricted and carefully monitored. National banks should ensure that their information security program or that of their TSP includes the evaluation and appropriate disposition of the above-mentioned recommendations based upon their environment and risk profile. The US-CERT EWIN contains a list of domains associated with malicious activity. National banks and their TSPs should prohibit network traffic, inbound and outbound, within those domains.

Click here and here to read more.

FDIC Board Approves Proposed Rule on Retail Foreign Exchange Transactions

On May 10, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) approved a proposed rule to adopt requirements for FDIC-supervised institutions that may engage in certain foreign exchange transactions with retail customers which fall under the provisions of Section 742 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. As amended by the Dodd-Frank Act, the Commodity Exchange Act (CEA) provides that a U.S. financial institution for which there is a federal regulatory agency shall not enter into, or offer to enter into, a transaction described in Section 2(c)(2)(B)(i)(I) of the CEA with a retail customer except pursuant to a rule or regulation of a federal regulatory agency allowing the transaction under such terms and conditions as the federal regulatory agency shall prescribe ("retail forex rule"). The Dodd-Frank Act does not require that retail forex rules be issued jointly, or on a coordinated basis, with any other federal regulatory agency. While each federal banking agency is issuing a separate proposed rule, the federal banking agencies are coordinating their efforts. According to the FDIC, its notice of proposed rulemaking is substantially similar to the OCC's notice of proposed rulemaking regarding retail foreign currency transactions published on April 22 and regulations adopted by the Commodity Futures Trading Commission in September 2010.

The requirements in this proposed rule may overlap with applicable expectations contained in the Interagency Statement on Retail Sales of Nondeposit Investment Products (NDIP Policy Statement). After the effective date of the final version of this proposed rule, the FDIC will expect FDIC-supervised insured depository institutions engaging in or offering retail forex transactions to also comply with the NDIP Policy Statement to the extent such compliance does not conflict with the requirements of the FDIC's final retail forex rule.

The proposed rule applies only to transactions with retail customers who are not Eligible Contract Participants, and only to futures, options and similar transactions, such as rolling spot trades. It does not cover forward contracts or spot contracts. The proposed rule focuses on the safety and soundness of the underlying transactions through enhanced margin requirements and consumer protection through enhanced disclosure requirements among other elements. It establishes requirements dealing with disclosure, recordkeeping, capital and margin, reporting, business conduct and documentation.

While some small businesses may be considered retail customers under the proposed rule, the rule would not apply to foreign exchange forward contracts or spot contracts, which those businesses may use to manage their foreign exchange risks. In addition, the rule would not apply to transactions in the interbank forex market because participants in those markets are not retail customers. The comment period for the proposed rule will be for 30 days after its publication in the *Federal Register*.

Read more.

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