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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC, CFTC Announce Establishment of Joint Advisory Committee on Emerging Regulatory Issues

On May 11, the Securities and Exchange Commission and Commodities Futures Trading Commission announced the creation of a joint committee that will address emerging regulatory issues. The committee is authorized to conduct public meetings, submit reports and recommendations to the CFTC and SEC and otherwise serve as a vehicle for consideration of regulatory issues that mutually concern the CFTC and SEC. These issues include, but are not limited to, identifying emerging regulatory risks, assessing and quantifying the impact of such risks and their implications for investors and other market participants, and furthering the agencies' efforts towards regulatory harmonization

According to the SEC, the first item on the committee's agenda is conducting a review of the extreme volatility of the financial markets on May 6 and making recommendations related to market structure issues that may have contributed to the volatility, as well as disparate trading conventions and rules across various markets.

The committee will consist of approximately 10 to 15 members, including Brooksley Born, a former CFTC chair, and David Ruder, a former SEC chair, and will be co-chaired by the chairpersons of the SEC and the CFTC. The committee will serve in an advisory capacity only, and each agency alone will determine any actions to be taken and policies to be adopted in light of the advice or recommendations of the committee. The committee will operate for two years from the date of its establishment, unless the committee's charter is re-established or renewed.

To read the SEC and CFTC's joint press release regarding the creation of the committee, click here.
To read the statutory Notice of Federal Advisory Committee Establishment, click here.

BROKER DEALER

SEC Commissioner Issues Statement Supporting Fiduciary Duty for Broker-Dealers Who Provide Investment Advice

In a May 11 statement, Securities and Exchange Commission Commissioner Luis Aguilar "unequivocally" reiterated his support for the extension of a fiduciary duty to broker-dealers who provide investment advice. Commissioner Aguilar noted that there are serious consequences for investors receiving investment advice from broker-dealers who are not fiduciaries because broker-dealers who provide advisory services to their clients are not currently required to act in their clients' best interests. In his statement, Commissioner Aguilar also addressed the need for Congress to allow the SEC to become self-funded.

Click here to read Commissioner Aguilar's statement.

CBOE Harmonizes Guarantee and Profit Sharing, Customer Confirmation and Options Communications Rules with FINRA Rules

On May 4, the Securities and Exchange Commission issued Release No. 34-62034 describing immediately effective changes to Chicago Board Options Exchange, Incorporated (CBOE) Rules 9.11, 9.18 and 9.21. To harmonize with Financial Industry Regulatory Authority Rule 2360(b)(12), amended CBOE Rule 9.11 requires that customer confirmations disclose whether a transaction was an opening or closing transaction. To streamline with FINRA, amended Rule 9.18, among other things, clarifies that the prohibition against guarantees applies to persons associated with a member and replaces the language regarding profit sharing of a customer account with the language of FINRA Rule 2150(c). Under amended Rule 9.21, the options communications rule, CBOE adds

the term "market letters" to the definition of "correspondence" and deletes the same term in the definition of "sales literature" to correspond with FINRA Rule 2220 and NASD Rule 2210(a)(2).

Click here to read SEC Release No. 34-62034.

PRIVATE INVESTMENT FUNDS

Senators Propose Wall Street Reform Bill Amendment to Restrict High-Risk Proprietary Trading

On May 10, Senators Jeff Merkley (D-Ore.) and Carl Levin (D-Mich.) introduced an amendment to the Wall Street Reform Bill that would restrict proprietary trading by banks and nonbank financial institutions. The legislation is based on the Protect our Recovery through Oversight of Proprietary Trading Act (PROP Trading Act) and is similar to the "Volcker Rule." The Merkley-Levin amendment would specifically:

- prohibit banks, bank holding companies, and their affiliates and subsidiaries from (1) engaging in proprietary trading involving any security, commodity future or option thereon, swap, security-based swap, or other security or financial instrument as determined by the appropriate federal banking agencies; or (2) investing in or sponsoring a hedge fund or private equity fund; and
- subject any nonbank financial companies supervised by the Board of Governors of the Federal Reserve System (such as large Wall Street investment houses) to additional capital requirements and quantitative limits with regards to their proprietary trading and investments in, and sponsorships of, hedge funds or private investment funds.

The proposed amendment would not affect traditional client-oriented services such as (1) the purchase and sale of government obligations, (2) the purchase and sale of securities and other instruments in connection with underwriting, market-making or facilitation of customer relationships (to the extent that such activities are designed to not exceed the reasonable near term demands of clients, customers or counterparties), (3) risk mitigating hedging activities designed to reduce risk, (4) investments in small business investment companies designed primarily to promote the public welfare, and (5) the purchase and sale of securities and other instruments by regulated insurance companies, provided in each case that such activity does not result in a material conflict of interest, would not result in an unsafe and unsound exposure to high-risk assets or high-risk trading strategies, and would not pose a threat to the safety and soundness of the entity engaged in such activity or to U.S. financial stability.

To read Senator Levin's press release on the amendment, click here.
To read the proposed amendment, click here.
Click here for more information on the PROP Trading Act in the March 12 edition of *Corporate and Financial Weekly Digest*.

OTC DERIVATIVES

Judge Overseeing Lehman Brothers Bankruptcy Cases Issues Decision on Setoff in Bankruptcy and Directs Swedbank AB to Surrender Post-Petition Deposits

On May 5, the judge overseeing the bankruptcy case of Lehman Brothers Holdings Inc. issued an opinion refusing Swedbank AB's request to keep several million dollars in post-bankruptcy Lehman deposits as a setoff against pre-bankruptcy swap termination claims.

When Lehman petitioned for relief under the bankruptcy code in September 2008, Swedbank terminated several International Swaps and Derivatives Association (ISDA) Master Agreements under which Lehman was either a direct party or a guarantor. At the same time, Swedbank placed an "administrative hold" on a Lehman account that held 2.1 million Swedish Krona. The administrative hold prevented Lehman from withdrawing funds but allowed additional funds to be deposited. By November 2009, the balance in the account had increased to 85 million Swedish Krona. To recover some of its $38 million in termination damages, Swedbank sought to exercise setoff rights against all of the funds in the account—including the sums deposited *after* the start of its bankruptcy case.

In refusing Swedbank's efforts, the court focused on the plain language of Section 553 of the Bankruptcy Code which allows setoff only when: (1) the amount owed by the debtor is a pre-petition debt; (2) the debtor's claim against the creditor is a pre-petition claim; and (3) the debtor's claim against the creditor and the debt owed to the creditor are mutual. The judge found mutuality lacking because the funds in the account were deposited post-petition whereas Lehman's debt to Swedbank under the ISDA agreements arose pre-petition. The judge then went

on to reject Swedbank's argument that two swap-termination "safe harbor" provisions of the Bankruptcy Code provide an exception to the mutuality requirement. Ultimately, the judge ordered all post-petition deposits to be surrendered to Lehman. (*In re Lehman Brothers Holdings Inc.*, Bankr. Case No. 08-13555 (Bankr.S.D.N.Y. May 5, 2010))

CFTC

CFTC Issues Advisory Regarding Intraday Position Limit Violations

On May 7, the Division of Market Oversight (DMO) of the Commodity Futures Trading Commission issued an Advisory regarding speculative position limits, which apply to contracts listed on designated contract markets (DCMs) and to designated "significant price discovery contracts" listed on exempt commercial markets (ECMs). In its Advisory, DMO states that market participants must assess their compliance with speculative position limits, whether set by the CFTC (in the case of enumerated agricultural contracts) or by DCMs and ECMs (in the case of other contracts), on an ongoing basis during the trading day, and not merely at the end of the trading day. Accordingly, market participants whose positions exceed speculative position limits at any point during the trading day may be subject to CFTC enforcement action, even if they reduce their position prior to the end of the trading day (when daily large trader reports are filed).

The DMO Advisory is available here.

CFTC Permits Direct Access to Imarex Electronic Terminals within the U.S.

On May 11, the Division of Market Oversight of the Commodity Futures Trading Commission issued a no-action letter to International Maritime Exchange ASA (Imarex), which allows Imarex to permit direct electronic access to its trading system to Imarex trading members in the United States without Imarex registering as a designated contract market or derivative transaction execution facility. Imarex is a Norway-based exchange which lists cash-settled derivatives related to prices for freight and bunker fuel, and has operated as an exempt commercial market since 2001.

Pursuant to the no-action relief, Imarex may make its trading system available to (1) eligible contract participants (ECPs), as defined in Section 1a(12) of the Commodity Exchange Act, who are trading for their own account, (2) registered futures commission merchants (FCMs) and firms exempt from FCM registration pursuant to CFTC Rule 30.10 (Rule 30.10 firms) submitting orders for U.S. customers that qualify as ECPs (including orders received for transmission through automated order routing systems), and (3) registered and exempt commodity pool operators and commodity trading advisors submitting discretionary orders on behalf of pools or clients that qualify as ECPs (provided that an FCM or Rule 30.10 firm clears and guarantees such trades).

A copy of the Imarex no-action letter is available here.

Please see "SEC, CFTC Announce Establishment of Joint Advisory Committee on Emerging Regulatory Issues" in **SEC/Corporate** above.

LITIGATION

Venue Improper Despite Defendant's Significant Sales, Advertising

The U.S. District Court for the Eastern District of Pennsylvania ruled that a corporation named in a products liability suit did not reside in the district even though defendant had spent significant sums on advertising and realized substantial revenue from sales in the district.

Plaintiff, a Pennsylvania resident, commenced an action in the Eastern District of Pennsylvania after he suffered injuries from exposure to a heater sold by the defendant, an Ohio corporation. Defendant moved to dismiss or transfer the action on the basis that defendant did not "reside" in the district.

Plaintiff asserted that defendant's presence in the district was sufficient for it to be sued there, based on, among other things, defendant's more than $19 million of advertising in national print media distributed in the forum, $625,000 on national radio advertising which may have been received in the district, a $50,000 infomercial that aired in Philadelphia, and other regular solicitation of business through Internet, television and print media advertising. Additionally, defendant shipped over $13 million in merchandise to customers in the forum in the prior three years.

Even though the contacts appeared to be substantial, the court examined the facts within the context of defendant's overall advertising expenditures and sales revenues. For example, only 2.5% of defendant's print and 3.7% of defendant's television advertising expenditures were directed at the forum, and defendant's over $13 million in local sales represented only 1.7% of its total sales. The court concluded that defendant's contacts were part of a national sales and advertising effort that happened to reach the district, but that were not targeted at it. Accordingly, the court found that the defendant did not reside in the district, and directed the transfer of the case to the proper district. (*Henning v. Suarez Corp. Indus., Inc.*, No. 09 Civ. 4282, 2010 WL 1817257 (E.D.Pa. May 4, 2010))

True Financial Condition Securities Claims Survive Summary Judgment

The U.S. District Court for the Southern District of New York denied a motion for summary judgment filed by defendants AT&T Corp. and its president because sufficient issues of fact existed concerning whether defendants had misrepresented AT&T's true financial condition in connection with an initial public offering (IPO) of an AT&T business unit.

AT&T launched an IPO for its wireless unit, which was intended to "track" the performance of the unit as opposed to other segments of AT&T's business. Plaintiffs purchased AT&T common stock, not the wireless "tracking stock," and predicated securities fraud claims on allegedly misleading statements made in connection with the tracking stock IPO. Plaintiffs asserted that a press release and prospectus issued for the tracking stock IPO withheld information about the overall health of the company, particularly the performance of non-wireless AT&T units, and contended that cautionary language in the press release which warned investors not to change their estimates of AT&T's quarterly or annual results based "solely" on the wireless unit misled the common stock investors. Plaintiffs alleged that defendants knew that AT&T's upcoming first quarter results were disappointing, but withheld disclosure in order to boost the IPO. When AT&T released its quarterly results—substantially later than it had historically, and after the IPO—its share price declined dramatically.

AT&T argued that its decision not to release the quarterly results until after the IPO was a proper exercise of its business judgment. In rejecting AT&T's argument, the court found that because the tracking stock as well as AT&T's common stock declined when the first quarter results were released, a jury could find the information material, and denied the summary judgment motion. (*Anderson v. AT&T Corp.*, No. 07 Civ. 5913, 2010 WL 1780953 (S.D.N.Y. May 4, 2010))

BANKING

FDIC Releases Proposed Rule Regarding Reporting Requirements for Certain Large Insured Depository Institutions

On May 12, the Federal Deposit Insurance Corporation (FDIC) released a proposed rule that would require insured depository institutions (IDIs) that are subsidiaries of large and complex financial parent companies to submit to the FDIC analysis, information and contingent resolution plans that demonstrate such institution's ability to be separated from its parent and wound down or resolved in an orderly fashion (Proposed Rule). Such plans would assist the FDIC in its development of a reasonable strategy for the orderly resolution of such institution.

Depository institutions subject to this planning requirement are defined as those with greater than $10 billion in total assets that are owned or controlled by a parent company with more than $100 billion in total consolidated assets.

According to the accompanying release, the Proposed Rule is necessary because "opaque structures" have prevented the FDIC from "gaining access to information that is essential to the FDIC's assessment of its risks as insurer and to its ability to resolve the IDI in a cost-effective and timely fashion as receiver, in the event of failure."

The Proposed Rule also sets forth the elements which are required in a contingent resolution plan. These elements include descriptions of the following: organizational structure; business activities, relationships and counterparty exposures; capital structure; intra-group funding, transactions, accounts, exposures and concentrations; systemically important functions; material events; and cross-border elements.

For more information, click here.

EXECUTIVE COMPENSATION AND ERISA

Target Date Retirement Fund Investor Bulletin Issued by DOL and SEC

The Department of Labor Employee Benefits Security Administration (EBSA) and the Securities and Exchange Commission have published a bulletin about target date retirement funds (also known as "life cycle funds") that is intended to help investors and plan participants understand and evaluate such investments. The bulletin also is a useful resource for retirement plan sponsors and investment committees that are responsible for selecting and monitoring the investment alternatives available under retirement plans.

Target date funds are designed to simplify retirement investing for plan participants and other investors by using a combination of investments that is gradually adjusted to become more and more conservative as a fund's "target date" approaches. Investors often choose a particular target date fund based on their retirement time horizon. However, the investment strategies and adjustment timelines of different target date funds vary widely. Many investors and plan fiduciaries may not be aware of these differences, or may not know how to assess the differences. The EBSA/SEC guidance is intended to assist plan participants and other investors in evaluating the benefits and risks associated with target date funds and the appropriateness of investing their retirement assets in such funds.

The bulletin provides an overview of how target date funds are designed and intended to operate, including examples of differences in asset allocation methods and adjustment timeframes that may be used by various funds. The guidance discusses key considerations for evaluating target date funds and outlines factors for investors to consider before investing in a particular target date fund. The bulletin also lists other resources issued by the Department of Labor, the SEC and the Financial Industry Regulatory Authority that may be helpful to investors.

The guidance, "Investor Bulletin: Target Date Retirement Funds," is available here. According to Louis Campagna, chief of the EBSA Division of Fiduciary Interpretations, EBSA also is compiling a target date funds checklist for retirement plan sponsors.

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