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Corporate and Financial Weekly Digest

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SEC/Corporate

Guidance for Compliance with Section 404 of Sarbanes Oxley Approved

On May 23, the Securities and Exchange Commission unanimously approved interpretive guidance to help public companies strengthen their internal control over financial reporting while reducing unnecessary costs, particularly at smaller companies. The new guidance will focus company management on the internal controls that best protect against the risk of a material financial misstatement. SEC Chairman Christopher Cox stated that the new guidance will enable "companies of all sizes ... to scale and tailor their evaluation procedures according to the facts and circumstances. And investors will benefit from reduced compliance costs." John W. White, Director of the SEC's Division of Corporation Finance added that the "interpretive guidance should reduce uncertainty about what constitutes a reasonable approach to management's evaluation while maintaining flexibility for companies that have already developed their own assessment procedures and tools that serve the company and its investors well."

The SEC also approved rule amendments providing that a company that performs an evaluation of internal control in accordance with the interpretive guidance satisfies the annual evaluation required by Rules 13a-15 and 15d-15 of Securities Exchange Act of 1934. The SEC also amended its rules to define the term "material weakness" as "a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis." The SEC also voted to revise the requirements regarding the auditor's attestation report on the effectiveness of internal control over financial reporting to more clearly convey that the auditor is not evaluating management's evaluation process but is opining directly on internal control over financial reporting.

The effective date of the interpretive guidance and adopted rules will be 30 days from their publication in the *Federal Register*. The full text of the interpretive guidance and rules will be posted to the SEC website as soon as possible.

http://www.sec.gov/news/press/2007/2007-101.htm

SEC Proposes to Modernize Smaller Company Capital – Raising and Disclosure Requirements

On May 23, the Securities and Exchange Commission proposed a series of six measures to modernize and improve its capital raising and reporting requirements for smaller companies. Many of the proposals address key recommendations made by the SEC's Advisory Committee on Smaller Public Companies in its final report. They include:

SEC/CORPORATE

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- A new system of securities regulation for smaller public companies that would expand eligibility for the SEC's scaled disclosure and reporting requirements for smaller companies by making the scaled requirements available to all companies with up to $75 million in public float and simplify the SEC's disclosure and reporting requirements for smaller companies eligible to use them—small business issuers and non-accelerated filers;

- Revise the eligibility requirements of Form S-3 and Form F-3 so companies with a public float below $75 million can take advantage of the benefits of shelf registration, provided such companies do not sell more than the equivalent of 20% of their public float in primary offerings registered on Form S-3 or Form F-3, as applicable, over any one-year period;

- Establish a new exemption from the registration requirements of the Securities Act of 1933 for sales of securities to a newly defined category of "qualified purchasers" in which limited advertising would be permitted and make certain other adjustments to the definitions and the integration safe harbor of Regulation D;

- Shorten the holding periods under Rule 144 of the Securities Act of 1933 for restricted securities and revise the resale provisions of Rule 145(d) of the Securities Act of 1933 to reduce the cost of capital and to increase access to capital;

- Establish new exemptions for compensatory employee stock options for private non-reporting issuers and for issuers that have registered under Section 12 of the Securities Exchange Act of 1934 the class of securities underlying the compensatory stock options, so registration requirements of the Securities Exchange Act of 1934 would not be triggered solely by a company's compensation decisions; and

- Mandate the electronic filing of the information required by Form D using a new online filing system that would be accessible using the Internet and that would automatically capture and tag data items, and revise and update the Form D information requirements.

SEC Chairman Christopher Cox stated " This focus on capital formation and the removal of obstacles to the growth of smaller companies goes hand-in-hand with our responsibility to protect investors."

Comments on these proposals should be received by the SEC within 60 days of their publication in the *Federal Register*.

The full text of the detailed releases concerning these items will be posted to the SEC website as soon as possible.

http://www.sec.gov/news/press/2007/2007-102.htm

Broker Dealer

Rule Changes Regarding Business Entertainment Proposed

NASD and NYSE have filed substantially similar proposals with the Securities and Exchange Commission regarding their members' provision of "business entertainment," defined to include various social events and leisure activities and any related transportation or lodging. Under the proposed rules, members are prohibited from directly or indirectly providing business entertainment to a

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customer representative that is either intended or designed to, or would be reasonably judged to have the likely effect of causing, such representative to act inconsistently with the customer's best interests or the best interests of any person to whom the customer owes a fiduciary duty. This prohibition would apply to entertaining customer representatives (such as an employee or officer of the customer), but not to entertainment provided directly to individual (natural person) customers. Members that do not engage in business entertainment would not be subject to the proposed rules, and a partial exemption is proposed for firms with annual business entertainment expenses of less than $7,500.

The proposals provide that anything of value given to a customer representative that does not qualify as business entertainment will be treated as a gift and subject to the limitations applicable to gifts. Both proposals also make clear that generally an associated person of the member firm must accompany the customer representative for an event to qualify as business entertainment rather than a gift.

The proposed rules would require members to adopt written policies and procedures that, among other things, define appropriate and inappropriate forms of business entertainment and set certain thresholds for entertainment expenditures. Such policies and procedures must be reasonably designed to detect abuses or circumvention of the business entertainment rules and must specify the methodology for valuing business entertainment expenses (generally, the higher of face value or cost). Members also would be required to keep detailed records of the business entertainment provided to any customer representative, subject to limited exceptions, and must make such records available to the customer upon request.

Both proposals request an effective date for the rule changes of six months following SEC approval. The comment period for the NYSE proposal closes June 11, and the comment period for the NASD proposal closes June 12.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-9742.pdf

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-9668.pdf

ISE to Provide Members with Information Regarding Public Customer Interest

The Securities and Exchange Commission has approved a rule change proposed by the International Securities Exchange (ISE), which allows ISE to make information regarding the quantity of public customer contracts included at the ISE's best bid and offer available to all ISE members. Previously, this information was only made available to Primary Market Makers.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-9664.pdf

Banking

FinCEN Delays Implementation of Revised Suspicious Activity Reports

On April 26, the Financial Crimes Enforcement Network (FinCEN) filed a Federal Register notice announcing the delayed implementation of certain revised Suspicious Activity Report (SAR) forms, intended to facilitate joint filings. The SAR forms were scheduled to become effective on June 30. FinCEN is withdrawing the effective date for the revised SAR forms for

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depository institutions, casinos and card clubs, insurance companies, and the securities and futures industries.

This announcement does not affect the Bank Secrecy Act filing requirements, and financial institutions should continue filing using the current SAR forms. FinCEN will establish new effective and mandatory compliance dates for these revised forms in a future notice.

http://www.fincen.gov/sar_fr_notice.pdf

United Kingdom Developments

UK Crime Agency Publishes First Annual Report

The UK's Serious Organised Crime Agency (SOCA) published its first annual report on May 18. SOCA, the British equivalent of the FBI, was launched to target resources in fighting organized crime and was formed in 2006 following the merger of the National Criminal Intelligence Service, the National Crime Squad and other law enforcement bodies.

Although SOCA has more than 4,000 officers and an annual budget of £400 million (approximately $800 million), the agency has prosecuted an average of just 30 people a month in its first year. However, the report highlighted SOCA's successes in combating drug trafficking. In the last year, SOCA has seized a fifth of Europe's cocaine supply, with a street value of £3 billion (approximately $6 billion), and has also seized 1.5 tonnes of heroin, 4.4 million ecstasy tablets, 260 kilos of opium and 1 million doses of LSD.

SOCA has identified an initial target list of more than 1,600 of Britain's "most wanted" criminals and SOCA is currently focusing on 160 individuals involved with money-laundering, drug trafficking, human smuggling and electronic fraud.

http://www.soca.gov.uk/assessPublications/downloads/SOCAAnnualRep2006_7.pdf

FSA Publishes MiFID Notifications Guide

On May 23, the Financial Services Authority (FSA) published the *MiFID Permissions and Notifications Guide*. The guide explains the changes that firms must make in implementing the EU Markets in Financial Instruments Directive (MiFID) by November 1. Many of the MiFID requirements will also be applied to non-MiFID business.

The guide covers such things as MiFID waivers, client categorization, passporting, tied agents, client money and approved persons. It also includes maps and tables setting out how MiFID services, activities and financial instruments relate to the existing EU Investment Services Directive, which is being replaced by MiFID, and to the EU Banking Consolidation Directive.

http://www.fsa.gov.uk/pubs/international/mifid_guide.pdf

Litigation

"Fraud on the Market" Presumption Requires Showing of Loss Causation

Plaintiffs, common stock investors in Allegiance, a national telecommunications provider, brought a securities fraud class action lawsuit

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LITIGATION

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under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 alleging that former Allegiance executives fraudulently misrepresented information about the company's operations, which resulted in a drop in the company's stock price when a corrective disclosure was ultimately made. The District Court certified Plaintiffs' class based on the "fraud on the market theory," which permits the court to presume that each class member has satisfied the reliance element of a 10b-5 claim.

The Fifth Circuit Court of Appeals, in a decision that the dissenting Judge characterized as "a breathtaking revision of securities class action procedure," reversed. The Court ruled that class certification based on the fraud-on-the-market doctrine must be supported by a showing by a preponderance of the evidence of "loss causation," i.e., an empirically-based showing that the market reacted negatively to the corrective disclosure of the alleged misrepresentations. In justifying its imposition of this requirement at the class certification stage, the court noted both the "lethal force" and "*in terrorem*" effect upon defendants of certifying a class based upon the fraud on the market doctrine.

The Court then examined the corrective disclosure relied upon by plaintiffs, which both corrected the alleged misrepresentations and included other negative information about the company. Because the plaintiffs' showing of the effect of the disclosure did not isolate and establish the negative impact, if any, attributable solely to correcting the misrepresentations, the court vacated the order and remanded the case for further proceedings. (*Oscar Private Equity Investments v. Allegiance Telecom, Inc.*, 2007 WL 1430225 (5th Cir. May 16, 2007))

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NFA Issues Notice Regarding Disclosure of Conflicts of Interest by CPOs and CTAs

On May 24, the National Futures Association issued an interpretive notice to provide guidance to commodity pool operators (CPOs) and commodity trading advisors (CTAs) in disclosing certain common conflicts of interest it has encountered in reviewing CPO/CTA disclosure documents. Notice I-07-25 addresses the following situations: (i) when a CPO/CTA (or an affiliate) is also an introducing broker (IB) or futures commission merchant (FCM); (ii) when a principal of a CPO/CTA is also a principal or associated person of an IB or FCM; (iii) when a CPO is receiving payments from a CTA; and (iv) when a commodity pool makes loans to affiliated entities or persons.

http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=1855

Relief Granted to NYMEX in Connection with Clearing Contracts Traded on the DME Trading System

On May 23, the Commodity Futures Trading Commission issued an order pursuant to Section 4d of the Commodity Exchange Act authorizing the New York Mercantile Exchange and registered futures commission merchants to hold Dubai Mercantile Exchange customer positions and associated funds in US customer segregated accounts. Separately, the CFTC's Division of Market Oversight issued a no-action letter permitting DME to make certain contracts listed on its electronic trading system available in the U.S.

http://www.cftc.gov/files/opa/press07/opaNYMEX-DME4dOrderfinal.pdf

http://www.cftc.gov/files/tm/letters/07letters/tm07-06.pdf

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