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Corporate and Financial Weekly Digest

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SEC/CORPORATE

SEC Division Deputy Director Discusses Expectations for 2010 Executive Compensation Disclosure

In a November 9 speech at the Fourth Annual Proxy Disclosure Conference: Tackling Your 2010 Compensation Disclosure, Shelley Parratt, Deputy Director of the Securities and Exchange Commission's Division of Corporation Finance, outlined the SEC staff's expectations for companies' executive compensation disclosure for the 2010 proxy season.

Against the backdrop of intense public scrutiny of executive compensation, Deputy Director Parratt urged public companies to enhance their executive compensation disclosure, particularly with respect to their compensation disclosure and analysis (CD&A). She noted that, too often, companies fail to include sufficient *analysis* of their compensation decisions in their CD&A disclosure. According to Ms. Parratt, a detailed discussion of the process used to determine executive compensation is inadequate to satisfy the requirements of CD&A absent a meaningful analysis of *why* named executive officers were compensated in a particular manner or amount. Although Ms. Parratt believes process-oriented disclosure of the framework in which compensation decisions are made may provide investors with important context for CD&A, disclosure should focus on how the company applied such framework, including any qualitative factors considered by the company, to determine the amount and structure of executive compensation. However, she added, "If a committee's pay determinations were simply subjective decisions, the company should say that."

She also stressed the need to enhance disclosure with respect to performance targets (benchmarks) used to make compensation decisions (i.e., "pay for performance"). According to Ms. Parratt, the staff issues "more comments on performance targets than any other executive compensation disclosure item."

Applicable rules require companies to disclose performance targets that are material to compensation policies and decisions, unless such information is confidential and disclosure would result in competitive harm to the registrant. As a threshold matter, Ms. Parratt suggested that a company should consider whether performance targets are in fact a material element of compensation policies and decisions, especially where such targets may be disregarded at the company's discretion or performance-based compensation may otherwise be awarded even if performance targets are not achieved. She said that "when a company states that it determined a material element of compensation [is] based on the achievement of performance targets, [the staff] will ask for specific disclosure of the targets and the actual achievement level against the targets, or for the company to provide [the staff] with an explanation of how such disclosure would cause it competitive harm." A company claiming that such disclosure would result in competitive harm should nonetheless provide meaningful and specific disclosure regarding how difficult or likely it would be for the undisclosed performance target to be achieved, she said.

Ms. Parratt stressed the need for issuers to be more proactive in updating their CD&A disclosure to reflect staff interpretations expressed in publicly available comment letters and other guidance regarding CD&A. According to Ms. Parratt, "after three years of [staff comments that are applicable only to companies' future filings, the staff] expects companies and their advisors to understand [the SEC's] rules and apply them thoroughly. So, any company that waits until it receives staff comments to comply with the disclosure requirements should be prepared to amend its filings if it does not materially comply with the rules."

Click here to view the complete text of Deputy Director Parratt's speech.

LITIGATION

Ninth Circuit Overrides Lower Court Lead Counsel Appointment

The Ninth Circuit ruled that the district court erred in refusing to appoint lead plaintiffs' chosen counsel in a consolidated securities class action.

Plaintiffs, investors in a technology corporation, alleged that the defendant had fraudulently concealed issues which led to a substantial decline in share price. The district court appointed co-lead plaintiffs to prosecute the action. However, the court did not appoint counsel chosen by one of the lead plaintiffs, instead choosing the attorneys that represented a third plaintiff group which were not chosen as a co-lead plaintiff. Co-lead plaintiff petitioned for a writ of mandamus, arguing that the district court's appointment was beyond its statutory authority. Non-lead plaintiff argued that the district court acted within its discretion in appointing their counsel because under the Private Securities Litigation Reform Act, the authority to select counsel by lead plaintiff is subject to court approval. The Ninth Circuit held that the discretion to approve lead counsel did not include the authority to appoint a different lead counsel; instead, the power to select counsel remains with lead plaintiff. (*In re Roberto Cohen*, No. 09-70378, 2009 WL 3681701 (9th Cir. Nov. 5, 2009))

Amended Complaint Cures Defective Scienter Allegations

The U.S. District Court for the Northern District of California denied a motion to dismiss after plaintiffs in a securities fraud action amended their complaint to add statements based on confidential witness information and other allegations.

Plaintiffs owned shares in defendant corporation, historically a conservative insurer of "full documentation home mortgages," which later began insuring higher-risk loan products and purchased a controlling share in a guarantor of subprime residential mortgage-backed securities. Plaintiffs alleged that defendant corporation and its officers and directors abandoned their core principles, exposed investors to unnecessary risk and falsely assured investors that they were closely monitoring risk. After the court dismissed plaintiffs' initial complaint, an amended version was filed and defendants again moved to dismiss. Plaintiffs alleged that defendants generated internal reports which showed that performance was well below the company's established standards and, further, that losses were mounting. Plaintiffs also relied on confidential witnesses and the fact that representations made during investor conference calls consistently failed to disclose defendants' underlying problems while acknowledging that credit quality was critical to future success. The court denied defendants' motion to dismiss the amended complaint in light of the new allegations. (*In re PMI Group, Inc.*, No. C 08-1405, 2009 WL 3681669 (N.D.Cal. Nov. 2, 2009))

BROKER DEALER

NYSE Regulation Reminds Members of Personal Trading Obligations

On October 30, NYSE Regulation, Inc. issued Information Memo 09-50 reminding members of their obligations under NYSE and NYSE Amex Equities Rules relating to members, employees and associated persons' trading in personal securities and commodities accounts. In the Information Memo, NYSE Regulation discusses NYSE Rule 407 and NYSE Amex Equities Rule 407's requirements that apply when a member opens or maintains a securities or commodities account in which an employee, member or associated person of another member or member organization or an exchange employee is directly or indirectly interested. In addition, the Information Memo reminds members to maintain reasonable and effective written supervisory policies and procedures to monitor the opening of and transactions in personal securities and commodities accounts and to conduct an internal investigation should any such transactions indicate a violation of federal securities laws prohibiting insider trading and manipulative and deceptive devices.

Click here to read Information Memo 09-50.

CBOE Proposes New "Professional" Order Type

The Chicago Board Options Exchange (CBOE) has proposed to adopt a new order type known as a "Professional" order. Under the proposed rule, the term Professional would include persons or entities that place more than 390 orders in listed options per day on average during a calendar month for their own beneficial accounts and are not broker-dealers in securities. A Professional will be treated in the same manner as a broker-dealer in securities for purposes of certain CBOE execution rules and will participate in CBOE's allocation process on equal terms with broker-dealer orders. If the rule change is approved by the Securities and Exchange Commission, the CBOE intends to implement the new order type on January 4, 2010, after which members will have five business days to make necessary changes to properly identify Professional orders.

Click here to read CBOE Regulatory Circular RG09-123.

PRIVATE INVESTMENT FUNDS

Senator Dodd Proposes Private Fund Investment Adviser Registration Act of 2009

On November 10, Senate Banking Committee Chairman Christopher Dodd released a discussion draft of the Restoring American Financial Stability Act of 2009. Included within this discussion draft is the Private Fund Investment Advisers Registration Act of 2009, proposed legislation that largely mirrors the act with the same name approved by the House Financial Services Committee on October 27, but with the following additional provisions:

- Advisors to private equity funds (a term left to the Securities and Exchange Commission to define by rulemaking) would not be subject to registration, although such advisors would still be required to maintain such records and provide the SEC with such annual or other reports as determined by the SEC.
- Advisors to family offices (a term left to the SEC to define by rulemaking) would not be subject to registration.
- The minimum threshold for advisor registration with the SEC would be raised from $25 million to $100 million, a move expected to increase the number of advisors under state supervision by 28%.
- The accredited investor standard would be increased to an amount greater than the current standard and thereafter indexed to inflation.
- Registered advisors would be required to provide information to the SEC about their portfolios necessary to assess systemic risk, including a description of (i) valuation methodologies, (ii) types of assets held and (iii) side letters.
- Registered advisors would be required to use independent custodians to hold client assets.

The proposed Senate bill does not include any of the amendments that were made to the House bill before approval by the House Financial Services Committee, including (i) the exemption from registration for advisors to private funds if each private fund managed has less than $150 million in assets under management in the United States; (ii) the exemption from registration for advisors of small business investment companies licensed under the Small Business Investment Act of 1958; (iii) the requirement that the SEC take into account, in the application of the rules, the level of systemic risk presented by "mid-sized private funds"; (iv) the prohibition against the SEC defining the term "client" to include an investor in a private fund where the fund has entered into the advisory agreement and (v) the indexing to inflation the dollar thresholds established by the SEC for determining who is a "qualified client."

To read the text of the Senate bill click here.

Click here to read the October 30 edition of *Corporate and Financial Weekly Digest* for more information on the similarly named House legislation.

OTC DERIVATIVES

ISDA Publishes Recommended Common Principles for Give-Up Agreements

On November 10, the International Swaps and Derivatives Association, Inc. (ISDA) announced that it published a set of recommended common principles intended to guide documentation for give-up agreements across central counterparties (CCPs) or clearing houses. Unlike the futures market in respect of which participants generally utilize standardized give-up agreements made available by the Futures Industry Association (in special consultation with the Futures and Options Association and the Managed Funds Association and certain other participants), no such standardized give-up agreements exist with respect to securities transactions effected among executing brokers, customers and their clearing members. As a result, there is uncertainty and a lack of uniformity in the market with respect to how certain fundamental elements of give-up arrangements are dealt with (e.g., how a trade rejected for clearing by a clearing member is handled and how the related breakage costs are allocated). The principles published by ISDA are the product of an ISDA-led working group comprising buy- and sell-side participants and CCPs and address the following areas: fallbacks in the event of rejection for clearing, ability to reject trades, reduction of trading limits, and determinations of market decisional bodies in relation to CCPs. Customers should inquire with their executing brokers and clearing members (generally their prime brokers) as to whether they intend to implement the principles, as doing so will reduce certain risks for customers and provide customers with greater certainty with respect to the basis on which transactions are rejected.

Read more.

CFTC

CFTC Adopts Amendments to Reporting Requirements for Commodity Pool Operators

The Commodity Futures Trading Commission has adopted amendments to its regulations regarding periodic and annual reporting requirements for commodity pool operators (CPOs). The amendments affect pools operated by CPOs that are "fully registered," as well as pools that are offered in reliance on the reporting, disclosure and recordkeeping exemptions provided by CFTC Regulation 4.7 (4.7 pools).

Among other things, the amended regulations require the periodic account statements for 4.7 pools to disclose either the net asset value per outstanding participation unit or the total value of the applicable participant's interest in the pool as of the end of the reporting period. The amendments also allow the operators of fully registered and 4.7 pools that are structured with multiple series or classes of ownership interests with limited liability among different series and classes to provide financial information in periodic account statements and annual reports only with respect to the particular series or class. For fully registered and 4.7 pools that operate as funds of funds, the amendments increase the maximum extension period for filing and distributing annual reports from 60 to 90 days (for a total of 180 days).

The amendments also codify prior CFTC staff positions on the proper accounting treatment and presentation of special allocations of ownership equity and the combined presentation of gains and losses for strategies involving both futures and related non-futures trading activities. The amendments additionally codify prior CFTC staff positions on the reporting of investee fund fees and expenses to investors, including in situations in which specific information about the calculation of such fees or expenses is unavailable. Reporting requirements for fully registered and 4.7 pools that are being liquidated are streamlined under the proposed amendments.

The amendments would also permit offshore pools to prepare financial statements in accordance with International Financial Reporting Standards (IFRS), rather than U.S. generally accepted accounting principles (GAAP), provided that information on the applicable accounting standards is disclosed in the pool's offering memorandum or other operative document provided to potential investors and certain other conditions are satisfied. Finally, the amendments remove the requirement that financial statements included in the annual reports for pools that are operated by CPOs that are exempt from registration with the CFTC under Regulation 4.13 be prepared in accordance with U.S. GAAP.

The CFTC press release on the amendments can be found here.
The Federal Register publication of the amendments can be found here.

BANKING

FDIC Issues Final Rule Regarding Prepayment of FDIC Insurance Assessments

On November 12, the Board of Directors of the Federal Deposit Insurance Corporation (FDIC) adopted a final rule requiring insured depository institutions to prepay their estimated quarterly regular risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 (the prepayment period) on December 30, 2009, at the same time such institutions would regularly pay their quarterly deposit insurance assessments for the third quarter of 2009.

The FDIC also issued a formula for calculation of the prepaid assessment and assumed that, for each quarter of the prepayment period, an institution's prepaid assessment base will increase from its third quarter 2009 assessment base at an annual rate of 5%.

Depository institutions will be permitted to apply a 0% risk weight to these prepaid assessments.

Exemptions from prepayment are possible if the FDIC, in consultation with the institution's primary federal regulator, determines that prepayment would adversely affect the safety and soundness of the institution. The FDIC also stated in its adoption of this rule that it expects that only a few institutions will apply for this exemption.

For more information, click here.

Please see “DIC Board Approves Interim Rule Extending Securitization Legal Isolation Safe Harbor Until March 31, 2010” in **Structured Finance and Securitization** below.

Please see “Banking Agencies Issue Final Rule for Mortgage Loans Modified Under HAMP” in **Structured Finance and Securitization** below.

STRUCTURED FINANCE AND SECURITIZATION

DIC Board Approves Interim Rule Extending Securitization Legal Isolation Safe Harbor Until March 31, 2010

On November 12, in response to concerns about the effect of the impending implementation of FAS 166/167, the Federal Deposit Insurance Corporation (FDIC) voted unanimously to provide a transitional rule that will allow all securitizations and participations that have been or will be issued in compliance with the 2000 FDIC safe harbor to continue to achieve the legal isolation safe harbor from the FDIC’s reach in the case of an insured depositary institution’s conservatorship or receivership (including if they were issued as off-balance sheet entities under accounting rules prior to implementation of FAS 166/167).

The FDIC will also provide this transitional safe harbor to all securitizations issued going forward until a new safe harbor is put in place that may have additional conditions that must be satisfied to achieve the safe harbor. The FDIC proposes the transitional safe harbor will be in place until at least March 31, 2010, although it is seeking comment as to whether the transitional safe harbor should be in place for a longer period of time until the new safe harbor is fully developed.

For transactions issued after March 31, the FDIC is expecting to issue a notice of proposed rulemaking at its December 15 board meeting seeking comment on a series of preconditions that would need to be satisfied before a securitization could achieve the new safe harbor.

The process of developing and reviewing these proposed rules will be an interagency process, including all of the primary bank regulators as well as the SEC.

For the interim rule, click here.
For a related FDIC memo, click here.

Banking Agencies Issue Final Rule for Mortgage Loans Modified Under HAMP

On November 13, the federal bank and thrift regulatory agencies issued a final rule providing that mortgage loans modified under the U.S. Treasury Department's Home Affordable Mortgage Program (HAMP) will generally retain the risk weight appropriate to the mortgage loan prior to modification.

The agencies adopted as final their interim final rule issued on June 30, with one modification. The final rule clarifies that mortgage loans whose HAMP modifications are in the trial period, and not yet permanent, qualify for the risk-based capital treatment contained in the rule.

The final rule, issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision, will take effect 30 days after publication in the Federal Register, which is expected shortly.

Click here for the Federal Register notice.

ANTITRUST

New York State Attorney General Brings Federal Antitrust Suit Against Intel

Following a 23-month long investigation, New York Attorney General Andrew Cuomo has filed a complaint against the world’s largest chip maker, Intel Corporation, alleging that it abused its dominant market position. The lawsuit piggybacks on the European Commission’s investigation of Intel, which resulted in a $1.56 billion fine last May. Although the Federal Trade Commission is conducting an ongoing investigation of Intel, New York’s suit represents the first action filed against Intel filed by a U.S. government agency following the European fine. It is a classic example of aggressive state enforcement, even when the federal antitrust regulators have yet to bring a lawsuit.

New York's complaint alleges that Intel abused its dominant market position to keep its primary rival, Advanced Micro Devices (AMD) from gaining market share. According to the complaint, Intel offered computer manufacturers hundreds of millions of dollars in illegal kickbacks to use Intel chips instead of AMD chips. Intel also allegedly threatened repercussions for any computer manufacturer that chose to use AMD chips. The evidence the Attorney General's office relies upon in its complaint parallels evidence collected during the European Commission's investigation, including emails and witness statements. This suit is further evidence of renewed interest among government regulators in curbing violations of Section 2 of the Sherman Act.

New York filed its lawsuit in the District of Delaware, where AMD had brought a private suit against Intel 4 years ago. That action was scheduled for trial in March 2010. However, on November 12, the private parties announced the settlement of the AMD lawsuit. Under the settlement agreement, Intel has agreed to (i) pay AMD $1.25 billion, (ii) enter into a cross license agreement with AMD and (iii) abide by a set of certain business practices. Although the private action is settled, the action filed by the New York regulators is still ongoing. (*New York v. Intel Corp.*, No. 2009cv00827 (D.Del. Nov. 4, 2009))

Click here to read the Intel press release.

EXECUTIVE COMPENSATION AND ERISA

Broad Pledge and Lien Provision in IRA Brokerage Agreement Is Prohibited Transaction

In Advisory Opinion 2009A-03, the Department of Labor (DOL) determined that it would be a prohibited transaction under Section 4975 of the Internal Revenue Code (Code) for an individual retirement account (IRA) to enter into a pledge and lien agreement involving a customer's regular brokerage account and the customer's IRA.

Code Section 4975 and Section 406 of the Employee Retirement Income Security Act of 1974 (ERISA) contain similar (but not identical) provisions on "prohibited transactions" between retirement plans and related parties. IRAs are not subject to ERISA, but they are subject to the Code's prohibited transaction provisions. The DOL has authority to issue regulations applicable to the prohibited transaction provisions of both the Code and ERISA. Thus, while the Advisory Opinion concerns an IRA, one would expect the DOL to apply the same reasoning to a pledge and lien agreement involving the accounts of a plan subject to ERISA and the plan's sponsoring employer.

In the situation described in the Advisory Opinion, an individual (Customer) had a personal brokerage account and wanted to open a self-directed IRA with the same broker. The broker's account agreement for the IRA included a pledge of all assets and a first lien to broker from any of Customer's accounts for any liability or indebtedness to broker in any of Customer's other accounts.

The Advisory Opinion states that a pledge of non-IRA assets for amounts owed by the IRA to the broker would be a prohibited transaction, because it is an extension of credit between Customer and the IRA, in violation of Code Section 4975(c)(1)(B), which prohibits loans or other extensions of credit between "disqualified persons" (which would include Customer) and a plan (including an IRA). The DOL said this was "akin to a guarantee of such debts by the IRA owner."

The DOL went on to say that the pledge and lien agreement also violated additional prohibited transaction provisions, involving use of, or self-dealing with, plan assets for the benefit of a disqualified person where it subjected the IRA account to debts of Customer's non-IRA accounts.

The Advisory Opinion is not surprising, insofar as it states that liens cannot be applied across accounts where some accounts are IRAs and others are non-IRAs, and we would expect that practitioners, if asked, have given advice consistent with that position. We would note that, in Class Exemption 80-26, as amended, the DOL has previously recognized that some extensions of credit between a plan and a party in interest or disqualified person which are for the benefit of the plan may, under certain circumstances, be permitted.

In light of this Advisory Opinion, pledge and lien provisions in customer agreements that would apply to IRAs or plans subject to ERISA should be examined, keeping in mind the potential application of existing statutory or regulatory exemptions.

The Advisory Opinion is available here.

For more information, contact:

SEC/CORPORATE

Robert L. Kohl	212.940.6380	robert.kohl@kattenlaw.com
Robert J. Wild	312.902.5567	robert.wild@kattenlaw.com
Jonathan D. Weiner	212.940.6349	jonathan.weiner@kattenlaw.com

LITIGATION

Bruce M. Sabados	212.940.6369	bruce.sabados@kattenlaw.com
Brian Schmidt	212.940.8579	brian.schmidt@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	212.940.6615	henry.bregstein@kattenlaw.com
Gary N. Distell	212.940.6490	gary.distell@kattenlaw.com
Daren R. Domina	212.940.6517	daren.domina@kattenlaw.com
Kevin M. Foley	312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	312.902.5241	arthur.hahn@kattenlaw.com
Patricia L. Levy	312.902.5322	patricia.levy@kattenlaw.com
Robert M. McLaughlin	212.940.8510	robert.mclaughlin@kattenlaw.com
Marilyn Selby Okoshi	212.940.8512	marilyn.okoshi@kattenlaw.com
Ross Pazzol	312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	212.940.8720	fred.santo@kattenlaw.com
Marybeth Sorady	202.625.3727	marybeth.sorady@kattenlaw.com
James Van De Graaff	312.902.5227	james.vandegraaff@kattenlaw.com
Meryl E. Wiener	212.940.8542	meryl.wiener@kattenlaw.com
Lance A. Zinman	312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	312.902.5334	krassimira.zourkova@kattenlaw.com

BANKING

Jeff Werthan	202.625.3569	jeff.werthan@kattenlaw.com
Terra K. Atkinson	704.344.3194	terra.atkinson@kattenlaw.com
Christina J. Grigorian	202.625.3541	christina.grigorian@kattenlaw.com
Adam Bolter	202.625.3665	adam.bolter@kattenlaw.com

STRUCTURED FINANCE AND SECURITIZATION

Eric S. Adams	212.940.6783	eric.adams@kattenlaw.com
Rachel B. Coan	212.940.8527	rachel.coan@kattenlaw.com
Hays Ellisen	212.940.6669	hays.ellisen@kattenlaw.com
Reid A. Mandel	312.902.5246	reid.mandel@kattenlaw.com

ANTITRUST

James J. Calder	212.940.6460	james.calder@kattenlaw.com
David S. Stoner	212.940.6493	david.stoner@kattenlaw.com

EXECUTIVE COMPENSATION AND ERISA

Gary W. Howell	312.902.5610	gary.howell@kattenlaw.com
Edward J. Rayner	212.940.8515	ed.rayner@kattenlaw.com

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Katten Muchin Rosenman LLP www.kattenlaw.com

CHARLOTTE CHICAGO IRVING LONDON LOS ANGELES NEW YORK PALO ALTO WASHINGTON, DC

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