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CORPORATE & FINANCIAL
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Please note that *Corporate and Financial Weekly Digest* will not be published on November 25. The next issue will be distributed on December 2.

BROKER DEALER

FINRA Reminds Firms of Their Obligations Regarding the Supervision of Registered Persons Using Senior Designations

The Financial Industry Regulatory Authority has issued Regulatory Notice 11-52 (the Notice) to remind firms of their supervisory obligations regarding the use of certifications and designations that imply expertise, certification, training or specialty in advising senior investors ("senior designations"). Examples of senior designations that FINRA has observed include "certified senior adviser," "senior specialist," "retirement specialist" or "certified financial gerontologist." FINRA encourages firms to consider the practices described in the Notice in assessing their own procedures and implementing improvements that will best protect their customers. The Notice provides that, at a minimum, firms must have supervisory procedures in place reasonably designed to prevent their registered persons from using a senior designation in a manner that is unethical or misleading. In addition, all advertisements and sales literature as defined in NASD Rule 2210(a), including communications that include the use of senior designations, must be approved in writing by a registered principal prior to use pursuant to NASD Rule 2210(b)(1). The Notice also includes recommended practices used by some firms that were provided to FINRA in response to a FINRA survey of 157 firms on the use and prevalence of senior designations. Those practices include standards by which firms approve senior designations, reviews of communications with the public to detect violative practices, required training sessions, and periodic certifications of senior designations.

Click here to read Regulatory Notice 11-52.

Broker Dealer and Investment Adviser Renewal Statements for 2012 Available on Web CRD/IARD

The Financial Industry Regulatory Authority has issued Regulatory Notice 11-51 to advise firms that the Preliminary Renewal Statements are available online on FINRA's Web CRD/IARD. The Preliminary Renewal Statements include a list of renewal fees, including: Web CRD system processing fees; FINRA branch office fees; FINRA branch renewal processing fees; maintenance fees for the various exchanges; state agent renewal fees; state broker dealer renewal fees; state broker dealer branch fees; investment adviser firm and representative renewal fees; and broker-dealer and/or investment adviser branch renewal fees. Full payment of the firms' Preliminary Renewal Statements must be received by FINRA no later than December 12, 2011. Firms may pay by check, wire transfer, or the Web CRD/IARD E-Pay application. FINRA will automatically transfer funds from a firm's daily account to its renewal account if the firm has not paid by December 12, provided there are sufficient funds in the daily account to cover the amount due. Failure by a firm to remit full payment of its Preliminary Renewal Statements to FINRA by December 12, 2011, may cause the firm to become ineligible to do business in the jurisdictions where it is registered, effective January 1, 2012. If a firm wishes to transfer funds between affiliated firms, the firm should submit a Web CRD/IARD Account Transfer Form available on FINRA's website.

On January 3, 2012, FINRA will make available all Final Renewal Statements on Web CRD/IARD. These statements reflect the status of broker-dealer, registered representative, investment adviser firm and investment adviser representative registrations and/or notice filings as of December 31, 2011. Any adjustments in fees owed resulting from registration terminations, approvals, notice filings or transitions after the Preliminary Renewal Statement appear on the Final Renewal Statement in Web CRD/IARD. Firms will have until February 3, 2012, to report any discrepancies on the renewal reports and to pay any necessary adjustments. FINRA advises that specific information and instructions concerning the Final Renewal Statement and renewal reports will be available in a January 2012 Regulatory Notice.

Click here to read Regulatory Notice 11-51.

LITIGATION

Court Adopts Model Order on E-Discovery in Patent Cases for Litigation Between Competitors

In a patent infringement suit between two competing technology firms, the U.S. District Court for the Northern District of California adopted the "Model Order on E-Discovery in Patent Cases" recently promulgated by a subcommittee of the Advisory Council of the Federal Circuit.

The Model Order provides for discovery in two phases. The first phase is an exchange of "core documentation" regarding the patent, the product, the prior art, and the parties' finances. The second involves an exchange of e-mails limited to particular issues warranting such discovery and no more than five search terms and five custodians.

The plaintiff opposed application of the Model Order on the ground that the Order was designed to address imbalances in the cost and volume of discovery in a cases brought by a "non-practicing entities" that have very little to produce. Because the plaintiff and the defendant were direct competitors in the industry, those inequities which the Model Order was designed to remedy were not at play.

The court rejected the plaintiff's argument and issued an order conforming to the Model Order. The court noted that evidence suggested that a mere .0074% of the documents produced in similar cases became exhibits at trial, and that the elimination of those costs was the purpose of the Model Order.

DCG Systems, Inc. v. Checkpoint Technologies, LLC, No. C-11-03792 PSG (N.D. Cal. Nov. 2, 2011).

Court of Chancery Analyzes Class Conflicts for Certification

The Delaware Court of Chancery granted a motion to certify a class of investor plaintiffs in a limited liability company, dismissing a claim raised by the defendant manager that there was a conflict of interest among class members.

The plaintiffs, former limited partners in Zon Capital Partners, L.P., filed claims for breach of fiduciary duties, breach of contract, negligent misrepresentation, and unjust enrichment against the former general partner of the LP entity. The complaint alleged that the defendant effectuated a self-interested conversion in which Zon Capital Partners, L.P. was converted into Zon Capital Partners, LLC. As a result of the conversion, the plaintiffs alleged, the distribution hierarchy was altered such that the general partner (now owner of Class C shares in the LLC) would receive payment on its carried interest calculated before payments made to the former limited partners (now owners of Class B shares). In contrast, under the LP structure the general partner (Class C owner) was paid carried interest calculated only after payments were made to the limited partners (Class B owners).

Defendants objected to including within the plaintiff class any Class B owner who also was an owner of Class A shares. At the time of the conversion, the general manager offered limited partners the opportunity to make additional capital contributions in the new LLC entity, with such new investments to be held as Class A shares (in addition to having their existing LP interests converted to Class B shares). According to the defendants, investors who in the new LLC structure were both Class A and Class B owners had a conflict with those who were only Class B owners because the Class A/B owners might be inclined to support the conversion in order to encourage the general partner (Class C) owner to continue its service as manager of the LLC entity.

The court rejected the defendants' argument as speculative and unsupported, concluding that the litigation sought only to take benefits away from the general partner (Class C owner) and transfer them to the Class B owners (with no potential conflict between Class A and Class B owners).

Garrett v. Zon Capital Partners, L.P., No. 5607-CS (Del. Ch. Nov. 10, 2011).

EXECUTIVE COMPENSATION AND ERISA

IRS Reverses Position and Timing of Bonus Deductions

In Revenue Ruling 2011-29 (the Ruling), the Internal Revenue Service (IRS) reversed a long-held position to now permit accrual-basis employers to accrue employee bonuses for federal income tax deduction purposes, even though the amount to be paid to specific employees is not known at the end of the year. Previously, the IRS had held that the deduction could not be claimed until both the identity of the bonus recipient and the specific amount of that bonus are both known.

The facts considered in the Ruling reflect a typical bonus arrangement in which the written terms of the employer's plan require that an aggregate minimum bonus amount be determined by year end with the allocation to individual employees determined after year-end. The minimum total amount of bonuses to be paid to the employee group is determined either through a formula that is fixed prior to year-end or through corporate action, such as resolution of the compensation committee of the board of directors, made before year-end. The plan in the ruling also provides that any bonus amount allocable to an employee who leaves the employer before the bonus is paid will be reallocated to other eligible employees. The IRS concluded that the minimum bonus amount determined under the plan could be accrued at year end if paid by the 15th day of the 3rd month following year end (March 15 for a calendar year taxpayer).

This result has long been considered the correct treatment by many tax advisors based on a Supreme Court ruling on a related issue. It is, however, important guidance that resolves a bothersome controversy with the IRS. The IRS has indicated in a related document, Revenue Procedure 2011-14, that it will allow an automatic accounting method change to implement the treatment permitted in Revenue Ruling 2011-29. This change may be useful to employers who now wish to conform their plans in order to accelerate the related federal income tax deduction to 2011 for bonus that are expected to be paid in early 2012.

Click here to read Revenue Ruling 2011-29.
Click here to read Section 19.01(2) of Revenue Procedure 2011-14.

BANKING

Agencies Issue Statement to Clarify Supervisory and Enforcement Responsibilities For Federal Consumer Financial Laws

On November 17, a statement was issued by the Bureau of Consumer Financial Protection (CFPB), the three federal banking agencies, and the National Credit Union Administration that explains how the total assets of an insured bank, thrift or credit union will be measured for purposes of determining supervisory and enforcement responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). Under section 1025 of the Dodd-Frank Act, the CFPB has exclusive authority to examine for compliance with federal consumer financial laws and primary authority to enforce those laws for institutions with total assets of more than $10 billion, and their affiliates. Section 1026 of the Dodd-Frank Act confirms that the four prudential regulators—the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency—will retain supervisory and enforcement authority for other institutions. The policy statement issued on November 17 clarifies the application of sections 1025 and 1026 of the Dodd-Frank Act by addressing two key matters: the measure to be used to determine asset size and the schedule for making such determinations.

The statement explains that a common measure of the asset size of an insured depository institution is the total assets reported in the quarterly Reports of Condition and Income that banks, thrifts, and insured credit unions are required to file with their respective primary federal regulators.

The policy statement also explains that the agencies are adapting measuring criteria used for deposit insurance assessment purposes. Accordingly, after an initial asset size determination based on June 30, 2011 data, an institution generally will not be reclassified unless four consecutive quarterly call or thrift financial reports indicate that the institution has switched categories of supervision, as follows:

- If an institution had total assets of greater than $10 billion as of June 30, 2011, and subsequently reported total assets of $10 billion or less for four consecutive quarters, the Institution would no longer be subject to the CFPB's supervisory or enforcement authority as a Large Institution.
- If an institution had total assets of $10 billion or less as of June 30, 2011, and subsequently reported total assets in excess of $10 billion in four consecutive quarters, the Institution would become subject to the CFPB's supervisory and enforcement authority as a Large Institution with respect to Federal consumer financial law beginning in the following quarter.
- If, in the case of an acquisition, merger, or combination involving an institution occurring after June 30, 2011, where each of the constituent entities has total assets of $10 billion or less before the transaction, the Agencies will review the combined assets of the constituent entities for the four quarters prior to the transaction to determine if the resulting institution is a Large Institution as necessary. For example, if two institutions merge, and neither constituent institution has total assets of greater than $10 billion, the resulting institution generally would be subject to the CFPB's supervisory and enforcement authority with respect to Federal consumer financial law beginning in the first full quarter after the merger is consummated if the combined total assets reported by the two Institutions were more than $10 billion in each of the four consecutive quarterly Call Reports prior to the merger. However, if the combined total assets reported by the two institutions were not more than $10 billion in each of the four consecutive quarterly Call Reports prior to the merger, the resulting institution would not be considered a Large Institution subject to the CFPB's supervisory and enforcement authority with respect to Federal consumer financial law. Subsequently, the resulting institution would become subject to the CFPB's supervisory and enforcement authority with respect to Federal consumer financial law as a Large Institution if it has reported total assets of greater than $10 billion in its quarterly Call Report for four consecutive quarters.

For more information, click here.

UK DEVELOPMENTS

European Parliament Passes Short Selling Regulation

On November 15, the European Parliament passed a resolution adopting, with amendments, the European Commission's proposal for a regulation on short selling and certain aspects of credit default swaps (CDS).

The European Parliament's amendments to the Commission's original proposal include:

- Restrictions on entering into an uncovered (naked) CDS relating to an obligation of a sovereign issuer.
- Excluding from the definition of short sale certain sales by either party under a repurchase agreement or securities lending agreement and entering into a futures contract or other derivatives contract where it is agreed to sell securities at a specified price at a future date.
- A new requirement that holders of significant net short positions keep records of their significant net short position for five years.
- The requirement to report net short positions equivalent to 0.5% or more of the issued share capital of an issuer remains.

The Regulation must now be formally approved by the European Council of Ministers. Although the text adopted by Parliament provides for the Regulation to apply from November 1, 2012, it is likely that the date it will come into effect will be 12 months after approval by the Council of Ministers.

For more information, click here.

ESMA Publishes Final Advice on AIFM Directive Implementing Measures

On November 16, the European Securities and Markets Authority (ESMA) published its final advice to the European Commission on possible implementing measures under the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD).

The rules proposed by ESMA are designed to establish a comprehensive framework for alternative investment funds (AIFs), their managers and depositaries and to help achieve the AIFMD's objective of increased transparency and tackling systemic risk. ESMA's advice, which runs to 500 pages, responds to a request by the European Commission, originally sent in December 2010 to ESMA's predecessor organization requesting the delivery of final advice by November 16 2011.

The advice covers four broad areas:

1. General provisions for managers, authorization and operating conditions

This clarifies the operation of the thresholds that determine whether an alternative investment fund manager (AIFM) is subject to the Directive. ESMA proposes to require AIFMs to have additional own funds and/or professional indemnity insurance to cover risks arising from professional negligence. A substantial number of the rules in this part of the advice, such as those on conflicts of interest, record keeping and organizational requirements are based on equivalent provisions of the EU's Markets in Financial Instruments Directive (MIFID) and Directives on Undertakings for Collection Investment in Transferable Securities (UCITS).

2. Depositaries

This part of the advice sets out the framework governing AIFs' depositaries. Key issues include the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country is equivalent to the AIFMD. These include the independence of the relevant authority, the requirements on eligibility of entities wishing to act as depositary and the existence of sanctions in the case of violations.

3. Transparency requirements and leverage

The advice clarifies the definition of leverage, how it should be calculated and in what circumstances a competent authority should be able to impose limits on the leverage a particular AIFM may employ.

4. Third countries

The AIFMD requires co-operation and exchange of information between EU and third country regulators. ESMA's advice envisages that the arrangements between EU and non-EU authorities with take the form of written agreements allowing for exchange of information for both supervisory and enforcement purposes.

Next Steps

The European Commission will now prepare implementing measures. It is anticipated that these will be based on ESMA's advice. In a letter from ESMA to the Commission published with the advice, ESMA indicates that it is currently working on or will start working on a number of supplemental issues and guidelines and technical standards including guidelines on remuneration policies.

For more information, click here.

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