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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Announces Roundtable on Mark-to-Market Accounting

The Securities and Exchange Commission announced that on October 29 it will host the first of two roundtables on "mark-to-market accounting" and current market conditions.

As described in the October 10, 2008 edition of *Corporate and Financial Weekly Digest*, the Emergency Economic Stabilization Act of 2008 mandated a study of mark-to-market accounting. The SEC's roundtable is designed to provide input for that study.

The roundtable will consist of two panels. The first of these will discuss the interaction between mark-to-market accounting for financial institutions and the current economic situation. The second panel will focus on potential improvements to Financial Accounting Standards Board (FASB) Statement No. 157 and implications of possible changes.

Panelists are expected to include investors, accountants, regulators, business leaders and other interested parties, with representatives of the FASB, International Accounting Standards Board and the Public Company Accounting Oversight Board as observers. The roundtable will be webcast on the SEC website.

www.sec.gov/news/press/2008/2008-252.htm

Litigation

Second Circuit Rules That Sarbanes-Oxley Whistleblower Claims Are Arbitrable

The plaintiff, defendant's Director of Internal Audit, believed that defendant's internal audit department was ineffective and "without independence or objectivity." After bringing her concerns to the attention of senior management, the plaintiff hired an outside auditor firm to review the company's internal controls. However, mere days before she was scheduled to discuss the outside auditor's findings with defendant's audit committee, plaintiff's employment was terminated.

Following her termination, plaintiff filed a lawsuit against her employer for violation of the whistleblower protection provision of the Sarbanes-Oxley Act (SOX). The defendant moved to dismiss on the grounds that plaintiff had agreed in writing to arbitrate all employment-related legal disputes before the American Arbitration Association. The plaintiff argued, among other things, that the SOX whistleblower claim was "categorically nonarbitrable" because arbitration of such claims would conflict with policy objectives of the

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whistleblower provision specifically and of SOX generally. The district court disagreed. Following its dismissal of the lawsuit, plaintiff appealed.

The Second Circuit also was not persuaded by plaintiff's argument that enforcing the arbitration clause would conflict with SOX's policy of providing the public with information about corporate fraud. After examining the legislative history of the whistleblower statute, the Second Circuit found that the purpose of the statute was to make the defendant whole, not to publicly denounce the company. The court specifically noted that both houses of Congress separately rejected versions of the Sarbanes-Oxley Act that would have prohibited mandatory arbitration of whistleblower claims. Accordingly, the court held that "the loss of a public forum in which to air allegations of fraud does not undermine the statutory purpose of a whistleblower protection provision." For this reason, and in order to uphold the strong federal policy favoring arbitration, the court affirmed the district court's dismissal of the plaintiff's claims. (*Guyden v. Aetna, Inc.*, 2008 WL 4426478 (2nd Cir. Oct. 2, 2008))

District Court Dismisses Securities Fraud Claim for Lack of Loss Causation

A district court dismissed securities fraud claims asserted against a corporation and one of its former directors. The plaintiffs invested over $5,000,000 in the corporation, which sold one-way pagers in China. Plaintiffs alleged that they made these investments in reliance on the company's financial statements, which they later learned did not reflect the company's obligation to make approximately $76,000 in salary payments to a former director. After the company fired the defendant from the board, he brought a successful claim against the company for his unpaid salary which the company could not satisfy from its liquid assets. Plaintiff alleged that as a result of this unsatisfied obligation, the plaintiffs' stock became "essentially worthless." Plaintiffs claimed that the failure of the company to disclose the unpaid salary on its financial statements was a material misstatement in violation of Section 10(b) of the Securities and Exchange Act and Rule 10b-5 that caused them to lose their multi-million dollar investment.

Defendants moved for the summary judgment dismissal of plaintiffs' claims on the grounds that no reasonable jury could find that the alleged misrepresentation caused plaintiffs' loss. The court granted the motion after finding that (i) the market in China for one-way pagers had experienced a steep decline subsequent to the time plaintiffs made their investment, (ii) the losses they sustained arose from the deterioration of the paging market, and (iii) the losses were "wholly unrelated to any misstatements that were made" regarding the unpaid salary. The court ruled that plaintiffs' inability to demonstrate a causal connection between the claimed misrepresentations and the harm they allegedly suffered was fatal to their claims. (*Shanahan v. Vallat*, 2008 WL 4525452 (S.D.N.Y. Oct. 3, 2008))

Broker Dealer

SEC Issues Additional Short Sale Rule Filings

The Securities and Exchange Commission adopted additional rules related to its recent actions to address concerns regarding short sales in light of the ongoing credit crisis. The rules generally extend certain actions that were initially taken on an emergency basis. First, the SEC adopted amendments to existing Regulation SHO to eliminate the options market maker exception to Regulation SHO close-out requirements. In this release, the SEC also included guidance regarding the scope of bona fide marketing activities for purposes of the market maker exception to the "locate" requirements. Second, the SEC adopted interim temporary rules to extend until August 1, 2009, the Form SH

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short sale reporting obligations that were initially imposed by emergency order. Third, the SEC finally adopted Rule 10b-21, an antifraud rule that prohibits persons from deceiving others about their intention or ability to deliver securities in time for settlement and fail to deliver securities by settlement date. Finally, the SEC adopted an interim final temporary rule to extend until July 31, 2009, the enhanced "Hard T+3" close-out requirements in Rule 204T. Rule 204T was first adopted by emergency order on September 17. The SEC called for industry comment on this issue.

http://www.sec.gov/rules/final/2008/34-58775.pdf
http://www.sec.gov/rules/final/2008/34-58785.pdf
http://www.sec.gov/rules/final/2008/34-58774.pdf
http://www.sec.gov/rules/final/2008/34-58773.pdf

NYSE Adopts Policy to Highlight Trade Reports Inconsistent with Prevailing Market

The New York Stock Exchange (NYSE) made a filing with the Securities and Exchange Commission to adopt a policy of attaching Aberrant Report Indicators to trade reports that the NYSE determines to be inconsistent with the prevailing market. The Consolidated Tape Association (CTA) offers participant exchanges, including the NYSE, discretion to append such indicators to trade reports. The purpose of the policy is to discourage vendors and other data recipients from using prices to which the NYSE has appended the Aberrant Report Indicator in any calculation of the high, low or last sale price of a security.

In the filing, the NYSE explained that it will retroactively append an Aberrant Report Indicator to trades that do not accurately reflect the prevailing market for a security when it was traded commencing as of January 1, 2007. Trades that are marked by the Aberrant Report Indicator are still valid trades, i.e., they were executed and not unwound as in the case of a clearly erroneous trade. The NYSE's filing included general numerical guidelines that will be consulted when determining whether trade prices are inconsistent with the prevailing market.

http://www.sec.gov/rules/sro/nyse/2008/34-58736.pdf

ISE Proposes Rule Change to Provide for a New Order Type

The International Securities Exchange, LLC (ISE) has filed with the Securities and Exchange Commission a proposal to amend ISE Rule 715 (Types of Orders) to provide for the submission of a new type of order, "attributable orders." Attributable orders are market or limit orders that allow an ISE member firm to voluntarily display its Firm ID (a unique 3-5 character identification code assigned by the ISE to each member firm) on the orders.

ISE has proposed these orders in response to requests by ISE members that believe that enhanced executions may be obtained if a Firm ID is allowed on orders (on a voluntary basis). ISE will issue a Regulatory Information Circular specifying the systems and the options classes for which the attributable order type will be available.

http://www.sec.gov/rules/sro/ise/2008/34-58701.pdf

ISE Proposes Rule Changes to Expand its Hours for Trading Equity Securities

The International Securities Exchange, LLC (ISE) has filed with the Securities and Exchange Commission a proposal to amend ISE Rule 2102 (Hours of Business) to expand its hours for trading equity securities and ISE Rule 2104 (Types of Orders) to adopt a new order type, "post-closing orders," for use

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during part of the expanded hours.

Currently, ISE has two equity securities trading sessions, the Pre-Market Session and the Regular Trading Session. The Pre-Market Session ends when the opening transaction occurs, at which time the Regular Market Session commences. The Regular Market Session concludes simultaneously with the primary listing market in such security, which is either 4:00 p.m. or 4:15 p.m. Eastern Time, depending on the security.

As proposed, the Pre-Market Session would begin at 8:00 a.m. Eastern Time instead of 9:00 a.m. Eastern Time. ISE is also proposing a new trading session, the Post-Trading Session, to begin after the conclusion of the Regular-Market Session for any security and to end at 5:00 p.m. Eastern Time.

ISE has also proposed several related rule changes in conjunction with the proposed expansion of equity trading hours. ISE currently requires certain members submitting orders during the Pre-Market Session to disclose certain risks of participating in that session and has proposed that this disclosure requirement be expanded to apply to the Post-Market Session. ISE has also proposed to adopt the rules governing trading halts in the Pre- and Post-Market Sessions.

http://www.sec.gov/rules/sro/ise/2008/34-58685.pdf

ISE Receives Approval for Changes to PIM Rules

The International Securities Exchange, LLC (ISE) received approval for rule changes that modify current Price Improvement Mechanism (PIM) auction eligibility requirements. Under current rules, Electronic Access Members are allowed to enter orders into the PIM only when there are at least three market makers quoting in the options series. The rule changes eliminate that requirement.

http://www.sec.gov/rules/sro/ise/2008/34-58710.pdf

Structured Finance and Securitization

Treasury Department Requests Comments on Troubled Asset Insurance Program

On October 14, the Treasury Department requested public input on an insurance program for troubled assets which is required by the Emergency Economic Stabilization Act of 2008 (EESA). The purpose of the program is to restore liquidity and stability to the financial system by guaranteeing principal of, and interest on, troubled assets originated or issued prior to March 14, 2008, while attempting to minimize the potential negative impact on taxpayers. Although the program may take any form and may vary by asset class, it must be voluntary and self-funding.

The Treasury Department is seeking comments on how the program should be structured to minimize adverse selection, including what events should trigger insurance payout, what form that payout should take, how premiums should be calculated, and which institutions and assets should be eligible. Comments are also being requested on technical considerations, including what legal, accounting, or regulatory issues would arise and what administrative challenges the program will create. The comment period extends until October 28, 2008.
http://www.treas.gov/press/releases/hp1212.htm
http://www.treas.gov/press/releases/reports/federalregisternotice1.pdf

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Fed Issues Report to Congress on Commercial Paper Funding Facility

On October 15, the Federal Reserve Board (Fed) issued a report to Congress regarding the newly established Commercial Paper Funding Facility (CPFF). The CPFF will provide a liquidity backstop to U.S. issuers of commercial paper through a special purpose vehicle (SPV) which will purchase three-month commercial paper, both asset-backed and unsecured, directly from eligible issuers. The Fed will provide financing to the SPV under the CPFF and will be secured by all of the assets of the SPV. Commercial paper that is not asset-backed will be secured by retention of up-front fees paid by the issuers. The Congressional report provides an overview of the CPFF and an outline of its terms and conditions.

http://www.federalreserve.gov/newsevents/press/monetary/20081007c.htm
http://banking.senate.gov/public/_files/101508_FedCommercialPaperReport.pdf

Banking

FDIC Creates New Program to Guarantee Bank Debt and Fully Insure Non-Interest Bearing Deposit Transaction Accounts

On October 14, on the same day that the Treasury Department announced its Capital Purchase Plan, as reported in an October 15 Katten *Client Advisory*, the Federal Deposit Insurance Corporation (FDIC) announced its own new program—the Temporary Liquidity Guarantee Program. The Program is intended to further strengthen confidence and encourage liquidity in the banking system by guaranteeing newly issued senior unsecured debt of banks, thrifts, and certain holding companies, and by providing full coverage of non-interest bearing deposit transaction accounts, regardless of dollar amount.

Under the plan, certain senior unsecured debt, issued on or before June 30, 2009, would be fully protected in the event the issuing institution subsequently fails or its holding company files for bankruptcy. This includes promissory notes, commercial paper, inter-bank funding, and any unsecured portion of secured debt. Coverage would be limited to June 30, 2012, even if the maturity extends beyond that date.

In addition, any participating depository institution will be able to provide full deposit insurance coverage for non-interest bearing deposit transaction accounts, regardless of dollar amount. These are mainly payment-processing accounts, such as payroll accounts used by businesses. Frequently, these exceed the current maximum limit of $250,000. This temporary guarantee expires on December 31, 2009.

Participating banks will be charged a 75 basis point fee to protect their new debt issues, and a 10 basis point surcharge will be added to a participating institution's current insurance assessment in order to fully cover the non-interest bearing deposit transaction accounts. All FDIC-insured institutions will be covered under the program for the first 30 days without incurring any costs. After that initial period, however, institutions no longer wishing to participate must opt out or be assessed for future participation. If an institution opts out, the guarantees are valid only for the first 30 days.

http://www.fdic.gov/news/news/press/2008/pr08100b.html

Banking Agencies Seek Comment on Proposal to Lower Risk Weights for Claims on or Guaranteed by Fannie Mae and Freddie Mac

On October 7, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance

BANKING

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Corporation and the Office of Thrift Supervision (each, an Agency, and collectively, the Banking Agencies) issued a notice of proposed rulemaking with respect to the risk weight for claims on, and the portion of claims guaranteed by, the Federal National Mortgage Association (Fannie Mae) or the Federal Home Loan Mortgage Corporation (Freddie Mac). The proposed 10 percent risk weight to be set forth in each Agency's risk-based capital rules would apply so long as an agreement remains in effect between the U.S. Treasury and Fannie Mae or Freddie Mac. The current risk weight for such claims is 20 percent.

The Banking Agencies believe reducing the risk weight from the current level to the 10 percent risk weight is appropriate in light of the financial support the U.S. Treasury provided to Fannie Mae and Freddie Mac in September through their senior preferred stock purchase agreements. In addition, the proposed rule is elective and "would apply only to banking organizations that choose to take advantage of the proposed 10 percent risk weight."

This proposal would not affect the calculation of the leverage ratio with respect to these exposures.

Comments are due 30 days after publication in the *Federal Register*.

http://www.occ.treas.gov/ftp/release/2008-119a.pdf

* Click here to access the *Corporate and Financial Weekly Digest* archive.

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