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SEC/CORPORATE

SEC to Propose Whistleblower Incentive Rules

The Dodd-Frank Wall Street Reform and Consumer Protection Act added Section 21F to the Securities Exchange Act of 1934. Section 21F mandates that the Securities and Exchange Commission, pursuant to regulations prescribed by the SEC, pay awards to eligible whistleblowers who voluntarily provide the Commission with "original information" about a violation of federal securities laws that leads to the successful enforcement of a "covered judicial or administrative action." The Dodd-Frank Act mandated awards range between 10% and 30% of monetary sanctions imposed, where such sanctions exceed $1 million. The SEC intends to propose whistleblower rules at its open meeting next Wednesday, November 3.

At a recent conference organized by the National Association of Corporate Directors, SEC Chairman Mary Shapiro, responding to concerns voiced that the Dodd-Frank whistleblower program would give employees at public companies very strong incentives to bypass corporate whistleblower programs and report alleged violations directly to the SEC, stated, "It is not our desire in any way, shape, or form to undermine the processes that great public companies have built in to ensure that they handle whistleblowers appropriately. We don't want to undermine what we view as a critically important component of regulation, and that is the corporate effort to ensure that whistleblowers are heard and their information is acted upon reasonably, and problems are fixed early on." Whatever rules are proposed by the SEC, they will need to address the balance between preserving corporate whistleblower programs and implementing the Dodd-Frank mandate.

Read more.

FINRA Revises Policy on Free Writing Prospectuses

The Financial Industry Regulatory Authority recently issued Regulatory Notice 10-52, which states that any free-writing prospectus (FWP) distributed by a broker-dealer in a manner reasonably designed to lead to a "broad unrestricted dissemination" as described in Rule 433(d)(1)(ii) of the Securities Act of 1933, is subject to the provisions of NASD Rules 2210 and 2211. FINRA's prior interpretation in 2006 had excluded such FWPs from the provisions of NASD Rules 2210 and 2211.

NASD Rules 2210 and 2211 establish standards for the content of communications with the public by broker-dealers and include principal review and filing requirements with FINRA. NASD Rule 2210(b)(1) requires a registered principal of the broker-dealer to review and approve each advertisement and item of sales literature before it is distributed. NASD Rule 2210(c)(2) requires that firms file advertisements and sales literature regarding securities of certain entities, such as registered investment companies and public direct participation programs, with FINRA within 10 business days of first use.

FINRA states that it is following guidance provided by the Securities and Exchange Commission as to the scope of the term "broad unrestricted dissemination." The SEC has noted that examples of broad unrestricted dissemination of an FWP by a broker-dealer would include posting an FWP on an unrestricted website or releasing it to the media. A posting of an FWP to a restricted website or an FWP sent directly to the broker-dealer's customers, regardless of the number of customers, does not constitute a broad unrestricted dissemination.

FINRA notes that if an FWP is distributed by a broker-dealer in a manner that is not reasonably designed to lead to its broad unrestricted dissemination, the exemptions from the provisions of NASD Rules 2210 and 2211 will continue to apply.

Read more.

FASB Delays Proposed Litigation Contingency Financial Statement Disclosure

On October 27, the Financial Accounting Standards Board (FASB) announced that it was delaying the effective date of its July 2010 exposure draft, *Contingencies (Topic 450): Disclosure of Certain Loss Contingencies*. The exposure draft had proposed that public entities would begin providing enhanced loss contingency disclosures in financial statements for fiscal years ending after December 15, 2010. The FASB will announce an effective date after its redeliberations based on the comments that it received.

Click here to read the FASB announcement and here to read the Exposure Draft.

BROKER DEALER

FINRA Amends Proposal to Adopt Streamlined Customer Confirmation Rule

The Financial Industry Regulatory Authority is requesting comment on an amendment to a proposed FINRA rule regarding customer confirmations. New FINRA Rule 2232 (Customer Confirmations) would replace the current National Association of Securities Dealers (NASD) and New York Stock Exchange (NYSE) rules, which generally govern disclosures made in connection with customer trades and the settlement thereof. The amendment to Rule 2232, which rule was originally filed by FINRA on August 24, 2009, limits the application of the settlement date provisions in the rule to "transactions in traditional equity securities," thereby excluding certain mutual fund and variable annuity transactions. FINRA intends the new rule, as amended, to be more straightforward and to streamline and combine the basic customer confirmation requirements currently set forth in NASD and NYSE rules. Comments are due by November 17.

Click here to read the SEC release regarding filing of Amendment No. 1 to FINRA Proposed Rule 2232, filed on September 16.
Click here to read the SEC release regarding filing of FINRA Proposed Rule 2232, filed on August 24, 2009.

CFTC

CFTC Announces Multiple Dodd-Frank Rulemakings

The Commodity Futures Trading Commission has issued five rule proposals and an advance notice of proposed rulemaking, five of which relate to rulemakings required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The sixth is not mandated by the Dodd-Frank Act, and relates to permitted investments of customer funds and funds held in foreign futures accounts.

- **Anti-Manipulation Rule:** Section 753 of the Dodd-Frank Act (which amended section 6(c) of the Commodity Exchange Act (CEA)) expanded the CFTC's anti-manipulation authority. To implement this expanded authority, the CFTC has proposed a new rule, modeled after Securities and Exchange Commission Rule 10b-5, prohibiting certain identified manipulative market practices. The proposed rule would render it illegal, with respect to any market under CFTC jurisdiction, for any person to (1) intentionally or recklessly engage or attempt to engage in a scheme to defraud or any practice which would defraud any person; (2) intentionally or recklessly make or attempt to make an untrue or misleading statement or an omission of material fact; (3) intentionally or recklessly deliver or attempt to deliver (or cause delivery or attempted delivery of) false or misleading crop or marketing information, or a report regarding conditions affecting prices of commodities in interstate commerce; or (4) directly or indirectly manipulate or attempt to manipulate the price of any such instrument.

- **Advance Notice of Proposed Rulemaking and Request for Comment on Disruptive Trading Practices:** Section 747 of the Dodd-Frank Act amended section 4c(a) of the CEA to expressly prohibit certain trading practices disruptive of fair and equitable trading, including engaging in any trading, practice, or conduct on or subject to the rules of a registered entity that (1) violates bids or offers; (2) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (3) is, is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution), as well as any other disruptive trading practice prohibited by the CFTC. The CFTC has approved an advanced notice of proposed rulemaking for publication in connection with the implementation of this provision of the Dodd-Frank Act. Among the areas on which the CFTC is requesting public comment are what, if any, additional trading practices should be prohibited as disruptive of fair and equitable trading, whether algorithmic traders should be held accountable for disrupting markets, and what duties of supervision over trades should be required to prevent disruptive trading practices.

- **CFTC Review of Rule Changes at Exchanges and Clearinghouses:** This proposal would establish a new framework for certification and approval of new products, new rules and rule amendments submitted to the CFTC by registered entities, which now include swap execution facilities and swap data repositories. Under the proposal, a new rule or rule amendment generally will become effective 10 business days after it is received by the CFTC. The CFTC may extend the review period for an additional 90 days if the new rule or rule amendment presents "novel or complex issues," if it lacks sufficient explanation, or if it is potentially inconsistent with the CEA or the CFTC's regulations. During that 90-day review period, the CFTC must provide the public with the opportunity to comment on the rule or rule amendment. The proposed rule also would require a "systemically important derivatives clearing organization" to provide the CFTC with a 60-day advance notice of any proposed change to its rules, procedures or operations that could "materially affect the nature or level" of risks presented by that entity, which the CFTC has indicated would include changes to financial resources, participant and product eligibility, risk management, settlement procedures, default procedures, disaster recovery or governance. Finally, the proposed rule would prohibit the listing, trading or clearing of a product that is based on certain excluded commodities and that involves terrorism, assassination, war, gaming, any activity that is unlawful under U.S. state or federal law, or any similar activity that the CFTC determines to be contrary to the public interest.

- **Swap Review Process:** This proposal is intended to implement provisions of the Dodd-Frank Act that require the CFTC to prescribe the processes and criteria for determining the eligibility of derivatives clearing organizations (DCOs) to clear swaps and for determining which swaps will be subject to mandatory clearing. Under the CFTC's proposal, DCOs would be presumed eligible to clear any swap that is of a category already cleared by that DCO, but would be required to submit a written request to the CFTC for an eligibility determination in order to accept additional categories of swaps for clearing. Such request must address the ability of the DCO to maintain compliance with DCO core principles in connection with the clearing of such swaps, as well as provide certain specific information about such swaps. DCOs would also be required to submit a statement to the CFTC with respect to those swaps that they seek to clear to assist the CFTC in determining whether clearing will be mandatory for such swaps. The statement must address various factors set forth in the Dodd-Frank Act, including outstanding notional exposures and liquidity for the applicable swaps; availability of rules and operational and credit support infrastructures for clearing of such swaps; and the effect of such clearing on the mitigation of systemic risk, among others. The CFTC would have 90 days to review the DCO's submission and make a determination, including a 30-day public comment period. The proposal also includes a process for the CFTC to initiate reviews of swaps not yet accepted for clearing by a DCO to determine whether clearing should be required.

- **Investment of Customer Funds:** In a rulemaking not mandated by the Dodd-Frank Act, the CFTC has proposed amendments to CFTC Rules 1.25 and 30.7 that would narrow the scope of permissible investments for customer funds held by futures commission merchants. Among other changes, the proposed rule would specify new concentration limits (instrument-based, issuer-based or both) with respect to all permitted instrument classes other than U.S. treasuries, and would restrict investments in the securities of government sponsored entities and other less-frequently used categories of securities to those instruments that are "fully guaranteed" as to principal and interest by the U.S. government. The proposal would also extend the investment restrictions applicable to customer segregated funds under CFTC Rule 1.25 to customer assets held in connection with positions in foreign futures and options under CFTC Rule 30.7, which currently are not subject to similar investment limitations.

- **Removal of Reliance on Credit Ratings:** Finally, the CFTC has also proposed rule amendments that would eliminate references to credit ratings in several CFTC regulations. Section 939A of the Dodd-Frank Act requires federal agencies to eliminate reliance on credit ratings in federal regulations and replace any references to credit ratings with appropriate standards of credit-worthiness. The CFTC is working with the SEC, the Federal Deposit Insurance Corporation and various other federal regulators to develop uniform standards of credit-worthiness.

The comment periods for the proposals regarding the removal of reliance on credit ratings and the investment of customer funds will expire 30 days from the dates of their respective publications in the *Federal Register*. The comment periods for the remaining proposals described above will expire 60 days from the dates of their respective publications in the *Federal Register*.

Information regarding all of the CFTC proposals, including the text of the *Federal Register* releases, fact sheets and Q&As, can be found here.

Treasury Department Requests Comments on Exemption for Foreign Exchange Swaps and Forwards

The U.S. Treasury Department has requested public comment on whether foreign exchange swaps and forwards should be exempted from the definition of a "swap" under the Commodity Exchange Act (CEA). Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Secretary of the Treasury is permitted to make a determination that foreign exchange swaps, foreign exchange forwards, or both, should be excluded from the CEA's "swap" definition, based on consideration of various enumerated factors.

In its request for comment, the Treasury has solicited comment on several specific questions, including the primary risks of, and risk management techniques in use in, the foreign exchange swaps and forward markets, and how mandatory clearing and exchange trading might affect market liquidity in the U.S. dollar, as well as U.S. dealers and end-users. The comment period expires on November 29.

A copy of the Treasury's request for comments is available here.

CFTC Proposes Definition of "Agricultural Commodities"

In response to certain amendments made by the Dodd-Frank Wall Street Reform and Consumer Protection Act relating to swaps in "agricultural commodities," the Commodity Futures Trading Commission has proposed to define "agricultural commodities" for the first time.

The CFTC's proposed definition would include all of the "enumerated commodities" listed in Section 1a of the Commodity Exchange Act (CEA), as well as:

- commodities derived from living organisms that are "generally fungible" and used primarily for human food, shelter, animal feed or natural fiber;
- tobacco, products of horticulture, and such other commodities used or consumed by animals or humans and designated by the CFTC as agricultural commodities; and
- commodity-based contracts (e.g., basis swaps and qualifying index contracts) based wholly or principally on a single underlying agricultural commodity.

The CFTC has requested comments on a number of aspects of the definition, including its exclusion of biofuels, and its potential impact on swaps currently transacted pursuant to CEA Sections 2(g) and 2(h). The comment period expires on November 26.

A copy of the CFTC release is available here.

LITIGATION

Second Circuit Affirms Dismissal in Madoff-Related Investor Action

The U.S. Court of Appeals for the Second Circuit affirmed the U.S. Bankruptcy Court for the Southern District of New York's dismissal of a complaint brought by Rosenman Family, LLC, an investor with Bernard L. Madoff Investment Securities LLC (BLMIS), against the trustee of BLMIS's estate. The complaint alleged that Rosenman was entitled to a return of $10 million it wired to BLMIS, because, Rosenman argued, the funds were stolen or embezzled by BLMIS and thus never became BLMIS's property and/or part of BLMIS's bankruptcy estate.

The bankruptcy court dismissed Rosenman's complaint on the ground that Rosenman was a "customer" under the Securities Investor Protection Act (SIPA). The court found that Rosenman had deposited cash with BLMIS for the purpose of purchasing securities, thereby invoking SIPA. The bankruptcy court concluded that Rosenman's investment was part of the estate.

The Second Circuit affirmed the bankruptcy court's finding that the funds were estate property, but rejected as premature its conclusion that Rosenman was a "customer" under SIPA. The Second Circuit reasoned that Rosenman's phone call with Madoff expressing interest in investing in the BLMIS fund, Rosenman's wiring of the funds in accordance with that phone call, the confirmation of BLMIS's purported purchase of securities for Rosenman's account, and the absence of any objection to that purported trade by Rosenman all demonstrated that Rosenman willingly transferred its money to BLMIS in contemplation of engaging in ongoing business dealings with BLMIS, thereby invoking SIPA, and thus the funds became part of the estate. (*Rosenman Family, LLC v. Picard,* No. 09-5296-bk, 2010 WL 3911370 (2d Cir. Oct. 7, 2010))

District Court Prohibits Use of Banking Logo

Plaintiffs, Puerto Rico-based financial institutions offering commercial banking services, sought a preliminary injunction prohibiting defendant, a Puerto Rico-based nonprofit banking institution that offered services similar to plaintiffs', from using its current mark and dress.

Plaintiffs used the term "Oriental" in connection with their businesses, services and products for decades; registered various versions of the term with the Puerto Rico Department of State Trademark Registry; and in 2010 applied to both that office and the U.S. Patent and Trademark Office to register "Oriental" for exclusive use in financial and banking services. Plaintiffs also prominently used the color orange in their advertisements.

Defendant had used the word "Oriental" in its name for a number of years, but in 2009 began using predominantly orange in its advertisements, on its website and on its storefront signs. The term "Oriental" was also made more prominent in defendant's logo.

The court determined that evidence existed that defendant's new logo and advertising campaign caused customer confusion and a loss of business, and entered a preliminary injunction against defendant. The court found that plaintiffs suffered an ongoing injury that could not be compensated, and that defendant unfairly benefited from plaintiffs' advertising efforts. Given the consumer confusion, the court concluded that an injunction preventing defendant from using its current mark and dress was necessary to prevent further harm to plaintiffs and to the public. (*Oriental Financial Group, Inc. v. Cooperativa De Ahorro Y Credito Oriental,* No. 10-1444, 2010 WL 4117236 (D.P.R. Oct. 20, 2010))

EXECUTIVE COMPENSATION AND ERISA

Second Circuit to Consider Employer's Discretion in Connection with LTIP

The U.S. Court of Appeals for the Second Circuit is considering the district court's decision in *Fishoff v. Coty Inc.*, which held that the Coty Board's broad discretion under its Long Term Incentive Compensation Plan (LTIP) did not include attributing two different fair market values to its stock for the same day.

Michael Fishoff, the former Chief Financial Officer of Coty Inc., a privately held corporation, was a participant in the company's LTIP. Upon exercise, the LTIP entitles a participant to a cash payment in an amount equal to the difference between the fair market value of Coty shares underlying the participant's options and the exercise price. On November 30, 2008, when Mr. Fishoff exercised his options, the most recent valuation of Coty's stock, in September 2008, had been $58 per share.

On December 5, 2008, the Coty Board met and decided that in light of deteriorating market conditions, the next valuation of its options needed to be conducted as soon as possible. An independent investment bank valued the Coty shares at $31 per share as of November 30, 2008. On December 11, 2008, Coty terminated Mr. Fishoff's employment without cause. Coty took the position that the $31 value applied to Mr. Fishoff's option shares even though the shares had been valued at $58 when he exercised. The difference between the $58 valuation and the $31 valuation of his 200,000 options was $7,612,000.

The decision of the district court implies that Coty may have given other plan participants who exercised at the same time as Mr. Fishoff the benefit of the $58 valuation. Coty argued that the LTIP gives it the discretion to do so.

While the LTIP does grant Coty's Board broad discretion with respect to the LTIP and the valuation of its shares, the district court noted that "[t]he LTIP does not explicitly permit Coty to assign different fair market values that are exercised on the same date."

The district court cautioned that reading such discretion into the LTIP "would create a risk of arbitrary conduct by the Board." The statement by the district court seems to suggest that there are limits to a plan administrator's discretion with regard to LTIPs, even where, as here, the LTIP does not require uniform treatment of all participants and gives the company board the discretion to value its stock at any time and even to apply such value retroactively.

It will be interesting to see if the Second Circuit will offer any clarification. It could be argued, for example, that an employer who chooses to value its shares more favorably for current employee-participants, as opposed to former (terminated) employee-participants is not being "arbitrary," but is rather exercising its business judgment. (*Fishoff v. Coty Inc.*, 676 F.Supp.2d 209 (S.D.N.Y. Dec. 16, 2009))

DOL Issues 401(k) Plan Participant Fee Disclosure Rules

On October 20, the U.S. Department of Labor (DOL) issued final regulations that will require certain Employee Retirement Income Security Act retirement plan sponsors to disclose to plan participants information about plan fees and expenses, as well as other information about available investment alternatives. The regulations go into effect for plan years beginning on or after November 1, 2011.

Compliance with the regulations' disclosure requirements will be required for plan sponsors of individual account retirement plans which allow for participant-directed investment of plan accounts, a typical feature for 401(k) and profit-sharing plans. Failure by a plan sponsor to provide the information required by the regulations will allow a plan participant or beneficiary to allege a breach of fiduciary duty—possibly making the plan sponsor liable for losses incurred by plan participants.

The regulations generally require plan sponsors to provide annual disclosure of (1) rules related to providing plan investment instructions (including limits on transfers as well as any voting rights a participant may have); (2) plan fees and expenses paid from participant accounts together with a description of the fees to be provided (e.g., legal, account, recordkeeping) and the method for allocating the amounts among participants; and (3) specific fees and charges that may be taken from the accounts of individual participants (e.g., loan fees, Qualified Domestic Relations Order processing fees, investment advice fees). If any of the foregoing information changes during the year, updated disclosure must be provided to participants at least 30 days prior to the implementation of any such change. In addition to the annual disclosures required by the regulations, plan sponsors must also provide quarterly statements disclosing to participants the amounts actually charged to their accounts.

The regulations also provide specific requirements regarding the information that must be made available to participants about each plan investment alternative. Much of this information is already provided in "fact sheets" that are typically available from most investment providers. However, the regulations require that participants be provided a summary chart that compares the relevant features (e.g., past performance, benchmark comparison, fees) of plan investment alternatives against each other.

Between the participant fee disclosure rules issued on October 20 and the service provider fee disclosure rules issued in July, the DOL has made clear that it views disclosure of retirement plan fees as a significant enforcement issue. Plan sponsors should work with service providers and investment providers to ensure compliance in order to preserve the protections available under the law.

The text of the DOL's participant fee disclosure rules can be found here.
Our prior description of the DOL's service provider fee rules can be found here.

UK DEVELOPMENTS

Government Announces Workplace Pension Reform

On October 27, the UK Government announced that it will implement pension reforms as suggested in the recently published report of an independent review team commissioned by the previous Labour government. Specifically, the team reviewed the practicalities of automatic enrollment in workplace pension schemes.

A new Pensions Act will introduce three key reforms to workplace pensions:

1) new legal duties requiring employers to automatically enroll eligible employees into a qualifying pension scheme;
2) a compliance regime enforced by The Pensions Regulator; and
3) the establishment of a new low-cost pension scheme, the National Employee Savings Trust (NEST). NEST will be available to all employers.

The reforms will apply to all employers, including those in small companies. Automatic enrollment will be phased, starting in October 2012 with the largest companies and continuing through 2016. By the end of this phasing period, all employers must enroll employees earning more than £7,500 (approximately $12,000) in a pension. Employer contributions will also be required for employees earning more than £5,700 (approximately $9,100). During the initial period between 2012 and 2016, employees and employers must contribute a collective minimum of 2% of earnings, with a minimum of 1% coming from the employer. From October 2012, once the reforms have been fully implemented, the minimum contribution will rise to 8% of earnings, with a minimum of 3% coming from the employer.

Employers will have the option of a three-month waiting period before automatic enrollment, to avoid having to enroll temporary workers.

To read more, click here.

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