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BROKER DEALER

SEC Launches Muni FA Registration System

On September 9, the Securities and Exchange Commission announced that it has adopted a temporary rule requiring municipal advisers to register with it by Oct. 1 in order to comply with the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act.

"We have acted expeditiously to create a temporary registration system to gather key data and provide transparency about municipal advisers," said SEC Chairman Mary Schapiro in a press release. "As a result, regulators, investors, and state and local governments will have a much better understanding of those who provide services in the municipal market."

The SEC expects to implement a permanent rule later this year. The temporary rule applies to all municipal advisers who provide advice to state and local governments and other borrowers involved in the issuance of municipal securities. The advice may be related to derivatives, guarantee investment contracts, investment strategies or the issuance of municipal securities. It also applies to municipal advisers who solicit business from a state or local government for a third party.

The SEC said these advisers should begin registering with the SEC as soon as possible because the Oct. 1 deadline is in less than a month.

The commission has provided a FORM MA-T for municipal advisers on its website.

FINRA Reminds Firms of Obligation to Provide Timely, Accurate and Complete Information on Form U5

The Financial Industry Regulatory Authority reminds firms of their obligation to provide timely, accurate and complete information on Form U5, Uniform Termination Notice for Securities Industry Registration. Firms must file Form U5 no later than 30 days after terminating an associated person's registration. Also, firms are required to file an amended Form U5 when they learn of circumstances or facts that make a previously filed Form U5 incomplete or inaccurate. Firms must provide the person whose registration has been terminated with a copy of any Form U5 (initial or amended) at the same time that it is filed with FINRA.

In addition, FINRA noted that every question on Form U5 stands on its own and firms should carefully read each question and respond appropriately to each question. Failing to provide accurate and complete information on Form U5 in a timely manner may subject firms to civil and administrative penalties.

Click here to read FINRA Regulatory Notice 10-39.

FINRA Releases Supplement to the Security Futures Risk Disclosure Statement

The Financial Industry Regulatory Authority has released the August 2010 Supplement to the October 2002 Security Futures Risk Disclosure Statement. The effective date for the Supplement is October 7. The Futures Risk

Statement has general disclosures on the risks and characteristics of security futures. The Supplement adds a new disclosure to accommodate OneChicago, LLC's proposed change to list a class of security futures for which adjustments will be made for ordinary dividends. The Supplement should be read with the Futures Risk Statement, both of which are available here.

To comply with the requirements of FINRA Rule 2370(b)(11)(A), firms may distribute the Supplement in a variety of ways, including, but not limited to: (1) distributing the Supplement to a customer who has already received the Futures Risk Statement not later than the time a confirmation of a transaction is delivered to every customer that enters into a security futures transaction, or (2) conducting a mass mailing of the Supplement to all customers approved to trade security futures who have already received the Futures Risk Statement.

Click here to read the FINRA Information Notice.

CFTC

CFTC Extends Comment Period for Proposed Ownership and Control Report; Roundtable Scheduled for September 16

The Commodity Futures Trading Commission has extended the period for public comment on its recent proposal to adopt a new account "Ownership and Control Report" (OCR), pursuant to which the CFTC would collect detailed account information from reporting entities on a weekly basis (including identifying and contact information with respect to both beneficial owners and account controllers, whether the account is traded pursuant to an automated system, the executing and clearing brokers, and an indication of whether the account is a firm omnibus account). The comment period on the CFTC proposal now closes on October 7.

Notice of the extension is available here, and the original CFTC proposal is available here.

The CFTC will also host a public roundtable on the OCR at 1:00 p.m. E.D.T. on September 16. Information regarding the roundtable, including dial-in information, is available here.

CFTC Adopts Final Rules for Retail Forex Transactions

The Commodity Futures Trading Commission has adopted final rules regarding over-the-counter foreign currency (forex) transactions with retail customers. The new rules are substantially similar to the rules proposed by the CFTC in January, and reflect the first body of final rules adopted by the CFTC in connection with its implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The rules institute a variety of requirements in connection with retail forex transactions, including registration, disclosure, recordkeeping, financial reporting, minimum capital and other standards and requirements.

Subject to certain exceptions for "otherwise regulated" entities, the new rules will generally require entities offering forex contracts to retail customers to register with the CFTC as either futures commission merchants (FCMs) or registered foreign exchange dealers (RFEDs), depending upon the nature of the business conducted by those entities. Persons who solicit orders, exercise discretionary trading authority and/or operate pools with respect to retail forex generally will be required to register as introducing brokers, commodity trading advisors, commodity pool operators or as associated persons of such entities, as appropriate.

The new rules also implement a minimum net capital requirement for RFEDs and FCMs offering retail forex transactions equal to $20 million plus 5% of the amount (if any) by which such registrant's liabilities to its retail forex customers exceeds $10 million. Significantly, the rules do not include the "10-to-1" leverage limitation for retail forex transactions that was included in the original proposal. Instead, the rules establish initial minimum security deposit requirements for retail forex contracts equal to 2% of the notional value for major currencies and 5% of the notional value for non-major currencies, and delegate authority to the National Futures Association to set higher security deposit requirements and to make changes in the designation of particular currencies as "major" currencies.

The CFTC press release announcing the new rules, which includes links to the final rules and a CFTC Q&A regarding the new rules, is available here.

CFTC Proposes Exemptions for Commodity ETF Operators

The Commodity Futures Trading Commission has proposed amendments to its Part 4 Rules to provide exemptions from certain requirements set forth in those rules with respect to the operation of "commodity ETFs," or pools for which the units of participation are sold in a registered public offering and listed for trading on a national securities exchange. The proposed amendments to CFTC Rule 4.12 would codify exemptive relief previously granted by CFTC staff to registered commodity pool operators (CPOs) operating commodity ETFs. The proposed amendments would permit CPOs to claim an exemption from certain disclosure, reporting and recordkeeping requirements otherwise applicable to CPOs, based on their substituted compliance with applicable securities law requirements. The CFTC has also proposed the adoption of a new Rule 4.13(a)(5), which provides an exemption from CPO registration for certain independent directors and trustees of commodity ETFs who serve on the commodity ETF's independent audit committee solely for purposes of compliance with federal securities laws.

The comment period for the CFTC's proposed rules will expire 45 days after their publication in the *Federal Register*. The CFTC press release, including a link to the *Federal Register* release, is available here.

NFA Sets Effective Date for Changes to Security Futures Risk Disclosure Statement

The National Futures Association (NFA) has set an October 7 effective date for recent amendments to its Interpretive Notice entitled "NFA Compliance Rule 2-30(b): Risk Disclosure Statement for Security Futures Contracts." Pursuant to NFA Compliance Rule 2-30(b), NFA members that are notice registered as broker-dealers and their associated persons are required to provide their customers with a risk disclosure statement regarding the trading of security futures products (SFPs) at or before the time that a customer's account is approved to trade SFPs. NFA members and associates with existing customers approved for SFP trading must distribute the amended paragraph of the risk disclosure statement to such customers no later than the time a confirmation of an SFP transaction is delivered to such customer.

The NFA Notice to Members regarding the amendments is available here.

CFTC to Provide Notice of Dodd-Frank Meetings with Outside Parties

Commodity Futures Trading Commission Chairman Gary Gensler has announced that the CFTC will publish a list of all meetings held by either the Chairman or CFTC staff with outside organizations regarding the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

The list will be published on the CFTC's website, and can be accessed here.

LITIGATION

Plaintiffs Fail to Allege Facts of Purposeful Deceit

Allegations that the directors of a technology company inflated the firm's business prospects and understated its potential liabilities will not support a claim for securities fraud because the plaintiffs did not sufficiently allege that the directors knew these projections were false when made.

Rackable Systems Inc. predicted robust earnings for the fourth quarter of 2006, but fell short of its goal by about five cents per share and announced in 2007 that it would shift its business model to provide more standardized inventory. The price of Rackable's shares fell 65%, and investors sued Rackable for securities fraud, alleging that the company overstated its business prospects and understated certain liabilities, such as a potential tax payment of about $1.2 million. Rackable moved to dismiss.

The plaintiffs argued that Rackable's directors knew that their projections were overly optimistic because they had hired an outside auditor to evaluate their business during that period and that the directors should have created a reserve for the potential tax payments. The U.S. District Court for the Northern District of California rejected these arguments, holding that the plaintiffs had not pleaded sufficient facts to show that the auditor's findings made the firm's projections misleading or that the tax liability was improperly disclosed. (*In re Rackable Sys., Inc. Sec. Litig.*, No. 09 Civ. 0222(CW), 2010 WL 3447857 (N.D. Cal. Aug. 27, 2010))

Directors Subject to Personal Liability for Alleged Securities Fraud

The principals of a pharmaceutical company could be held personally liable for securities fraud based on allegations that the defendants misled investors and used the firm as an alter ego for their own interests.

Five principals of Immunosyn Corp. allegedly induced two investors to invest $1.025 million in the company by promising that the firm had an exclusive right to sell a "super drug" called SF-1019, and that the investors would receive 102,500 free-trading shares of Immunosyn in exchange. The principals then purportedly sold the drug through other channels and forced the investors to accept restricted stock instead of free-trading shares. The investors sued Immunosyn and its principals, alleging fraudulent inducement and that the defendants were personally liable for any losses because they had commingled their personal and business assets.

The defendants sought dismissal, arguing that the investors had not provided sufficient details about the dates of the underlying misrepresentations and that they had provided only conclusory allegations that Immunosyn was the defendants' alter ego. The U.S. District Court for the Southern District of California disagreed, holding that the plaintiffs had identified a discrete timeframe for the misrepresentations of between early 2006 and May of that year, and that they had sufficiently alleged a failure to follow corporate formalities and a failure to segregate personal and business assets. (*Albergo v. Immunosyn Corp.*, No. 09 Civ. 2653(DMS), 2010 WL 3339398 (S.D. Cal. Aug. 24, 2010))

EXECUTIVE COMPENSATION AND ERISA

Seventh Circuit Permits Retroactive Correction to Benefit Plan

The U.S. Court of Appeals for the Seventh Circuit has recently allowed Verizon Communications, Inc. to correct a mistake in the drafting of its cash balance plan that could save Verizon over $1 billion in pension benefits.

The decision is one of first impression in the Seventh Circuit. The decision is remarkable because it is reported to conflict with the case law in a number of the other federal circuits dealing with a plan sponsor's ability to unilaterally correct retroactively a drafting error (a so-called "scrivener's error") in qualified retirement plan documents. The decision is also contrary to the IRS's consistently stated opinion that employers may not unilaterally correct retroactively drafting errors in plan documents.

The error in the *Verizon* case involved the operation of a "transition factor" used to determine the opening account balances of plan participants in the Verizon cash balance plan. The transition factor was mistakenly applied twice (rather than once) in the plan formula, resulting in very significant increases in the plan's benefit liabilities. Six drafts of the relevant plan provisions were prepared before the final version was adopted. A plan participant applying for benefits was denied the increased benefit resulting from the drafting error, and brought this action to enforce the explicit terms of the plan.

The IRS's position with respect to scrivener's errors is that qualified retirement plans are definite written programs providing definitely determinable benefits. Essentially, the plan is a contract which is enforceable by both the plan sponsor and the plan's participants and beneficiaries. As such, the plan, once adopted, may not be unilaterally "corrected" by the sponsoring employer.

The Seventh Circuit found that equitable reformation of the plan was indicated in this case where there was objective, clear and convincing evidence that the drafting error did not reflect "participants' reasonable expectations of benefits" and where the correction would avoid an "unfair result."

Even after *Verizon*, employers should take care in drafting and amending their plan documents. In deciding this case, the Seventh Circuit noted in relevant part (and citing cases in the Third and Seventh Circuits): "Only those who can marshal 'clear and convincing' evidence that plan language is contrary to the parties' expectations will have a viable claim... This standard of proof is rigorous, requiring evidence that is 'clear, precise, convincing and of the most satisfactory character that a mistake has occurred and that the mistake does not reflect the intent of the parties'... The evidence also must be 'objective' and not dependent on the credibility of testimony (oral or written) of an interested party'... These high standards of proof should deter an employer from seeking to reform plan language simply because it has proven unfavorable."

(*Young v. Verizon Bell Atlantic Cash Balance Plan*, 7th Cir., No. 09-3872, 8/10/10)

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