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SEC/Corporate

SEC Requests Additional Comment on Disclosure Requirement for Highly Compensated Employees

On September 8, the Securities and Exchange Commission requested additional comment on a proposed amendment to the disclosure requirements for executive and director compensation requiring compensation disclosure for highly compensated employees. The SEC had previously proposed this disclosure requirement, but did not adopt it as part of the final rules regarding disclosure of executive and director compensation released on August 11.

The request for additional comment specifically asks whether the proposal should be modified to apply only to large accelerated filers who would disclose the total compensation for the most recent fiscal year and a description of the job position for each of their three most highly compensated employees (whether or not such employees are executive officers) whose total compensation is greater than any of the named executive officers. However, employees who have no significant responsibility for significant policy decisions for the registrant or any principal business unit, division or function thereof would not be included in the determination of the three most highly compensated employees. The SEC provides several examples of employees who would qualify as having significant responsibility for policy decisions (including the director of the news division of a major network and the principal creative leader of the entertainment function of a media conglomerate), but noted that salespersons, entertainment personalities, professional athletes, traders or other investment professionals generally would not have such responsibility absent broader duties within a firm that went beyond those roles. Among the other specific requests for comment was a question as to whether these highly compensated employees should not be named due to privacy concerns.
http://www.sec.gov/rules/proposed/2006/33-8735.pdf

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Broker Dealer

NASD Proposes to Amend Rules Governing Conflicts of Interest in Public Offerings of Securities

The NASD recently issued Notice to Members 06-52 requesting comments to proposed amendments to NASD Rule 2720, which generally governs public offerings of securities issued by NASD members, public offerings in which a member or its associated persons have a "conflict of interest" and public

offerings resulting in a member becoming a public company. Such offerings typically must be filed for NASD review and the underwriting syndicate for such offerings must retain a qualified independent underwriter (QIU) in certain circumstances. The proposal would, among other things, (i) exempt certain public offerings from the filing requirements and QIU requirements of Rule 2720; (ii) expand the definition of "conflict of interest" to include public offerings in which at least five percent (down from ten percent in the current rule) of the offering proceeds are directed to a participating member or its affiliates; (iii) eliminate ownership of subordinated debt of the issuer as a basis for a conflict of interest; (iv) require more complete and prominent disclosure of information relating to conflicts of interest in offering documents; (v) eliminate the requirement that the QIU render a pricing opinion; and (vi) modify the QIU qualification requirements. Comments to the proposed amendments must be received by NASD no later than October 30.
http://www.nasd.com/web/groups/rules_regs/documents/notice_to_members/nasdw_017395.pdf

NASD Amends Rule 2340 Concerning Customer Account Statements

The Securities and Exchange Commission approved the proposed change to NASD Rule 2340 concerning required disclosures on customer account statements. Previously, clearing firms had the discretion to include language in customer account statements advising customers to immediately report to the firm any discrepancies in balances or positions. However, these advisories did not necessarily direct customers to report discrepancies in writing, nor were the advisories required to be included on customer account statements. The approved rule change amends the Rule to require firms to include in monthly account statements an advisory indicating that a customer should report promptly any inaccuracy or discrepancy in its account to its clearing firm and (if it is a different firm) its introducing firm, and informing customers that any oral communications should be re-confirmed in writing. NASD will announce the effective date of the proposed rule change in a Notice to Members.
http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/E6-15186.htm

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Banking

OCC Reiterates Internet Banking Warnings and Offers Guidance

In October 2005, the banking agencies issued guidance entitled *Authentication in an Internet Banking Environment*. The guidance focuses on the risks of fraud and identity theft associated with Internet banking activities. The guidance states that financial institutions should perform a risk assessment, identify and strengthen control weaknesses, measure and evaluate customer awareness efforts, and implement any necessary corrective actions. National banks are expected to have achieved conformance with the guidance by year-end 2006.

On September 8, the Office if the Comptroller of the Currency stated it anticipated that there will be increased activity by fraudsters to send false communications with the intent of obtaining customer information for the purposes of fraud and identity theft. OCC believes that these communications may attempt to exploit the December 31 conformance date. For example, communications purporting to be from a national bank could inform customers that, due to the agency guidance, the bank is required to

change its security procedures and, as a result, request customers to re-register or provide personal information that would enable the bank to comply with the regulatory requirement.

In addition to the common practice of cloning financial institution Web site, logo, and e-mail formats, such attempts may also use or include the official agency logos and may even contain or provide a link to the interagency guidance. The methods used to communicate with customers may include e-mail, telephone calls, and postal mail. Sophisticated schemes may employ multiple methods to "convince" the customer of their legitimacy.

In anticipation of this potential for fraudulent schemes, national banks should inform their customers well in advance of the year-end deadline of their plans and any changes to the bank's Internet or electronic banking applications, or that no changes are expected. Customers should be warned of possible fraudulent activity and about the types of information that may be requested, such as their social security number, account numbers, passwords, validation questions and answers. Banks should explain their policy regarding such information, e.g., "XYZ National Bank will not ask that you provide to us your social security number, account number, password, or personal identification number (PIN) as this is information we already have on file." Customers should be advised to call the bank for verification before responding to any such request. Banks should consider the establishment of a "hot-line" or toll-free number if one is not currently available.
http://www.occ.treas.gov/ftp/alert/2006-50.html

Federal Housing Finance Board Approves the Publication of a Proposed Federal Home Loan Bank Rating System

The Board of Directors of the Federal Housing Finance Board approved on September 13 a request by the Office of Supervision to publish in the Federal Register a notice seeking comments on a proposed Federal Home Loan Bank Rating System. Under the Office of Supervision's proposal, each Federal Home Loan Bank will be assigned a composite rating based on an evaluation and rating of five key components: corporate governance, market risk, credit risk, operational risk, and financial condition and performance.

The proposal will be published in the Federal Register and open for public comment for 30 days following publication. It is contemplated that the Rating System will be implemented with examination beginning after January 1, 2007.

The Federal Housing Finance Board is an independent agency in the executive branch that oversees the safety, soundness, and mission of the 12 regional Federal Home Loan Banks. The Banks are government-sponsored enterprises created in 1932 to provide low-cost funding for housing finance. They have more than 8,100 financial institutions as members, including commercial banks, savings and loans, insurance companies and federally insured credit unions.
http://www.fhfb.gov/GetFile.aspx?FileID=6028

FFIEC Releases 2005 HMDA Data

The Federal Financial Institutions Examination Council (FFIEC) released on September 8 the 2005 mortgage lending data collected from 8,848 financial institutions subject to Home Mortgage Disclosure (HMDA) reporting.

The data made available includes "disclosure statements for each financial institution, aggregate data for each metropolitan statistical area, nationwide summary statistics regarding lending patterns, and the Loan Application Register, modified for borrower privacy, submitted by each institution to its supervisory agency by March 1, 2006."

HMDA data shows the disposition of the loan application detailed by property location, applicant characteristics and census tract characteristics.

As noted in the FFIEC release, the "federal banking agencies analyze HMDA loan price data, in conjunction with other information, when evaluating fair lending risk."
http://www.ots.treas.gov/docs/7/776039.html

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Litigation

Department of Justice May Consider Modifying the Thompson Memorandum

Testifying before the Senate Judiciary Committee, Deputy Attorney General Paul J. McNulty indicated that the Department of Justice is considering making changes to the guidelines for pursuing criminal prosecutions of corporations that are set forth in the Thompson Memorandum. The guidelines in the Thompson Memorandum have been criticized recently by commentators, as well as members of the judiciary, as being coercive and as infringing on the attorney-client privilege. While Mr. McNulty defended the Thompson Memorandum against these criticisms, he also indicated that the Justice Department might consider making changes to the guidelines set forth in it.
(*The New York Times*, 9/13/06, p.3; http://judiciary.senate.gov/testimony.cfm?id=2054&wit_id=2742)

Plaintiffs Were Not Entitled to Recover Losses Under the Securities Investor Protection Act

Plaintiffs, victims of a Ponzi scheme, had accounts at two now defunct brokerage houses (Debtors) which contained investments in fictitious money market funds. Plaintiffs were subsequently induced to liquidate their accounts and make a loan to the Debtors and their principal. During the Debtors' bankruptcy proceeding, the Debtors were placed into liquidation under the Securities Investor Protection Act (SIPA). In an opinion that was reversed by the District Court, but reinstated by the Second Circuit, the bankruptcy court denied plaintiffs' SIPA customer claims for the face value of their loans to the Debtors. In reinstating the bankruptcy court's decision, the Second Circuit held that plaintiffs could not recover their losses under the SIPA because plaintiffs were lenders to, not customers of, the Debtors at the time the Debtors filed for bankruptcy. (*In re New Times Securities Services, Inc.*, No. 05-5527-BK, 2006 WL 2573954 (2d Cir. Sept. 7, 2006))

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