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Corporate and Financial Weekly Digest

**September 19, 2008**

## SEC/Corporate

### SEC Launches Voluntary Online Filing System for Form D

On September 15, the Securities and Exchange Commission began accepting filings of Form D through its EDGAR filing system as part of the SEC's overall efforts to reduce unnecessary paper filings and regulatory burdens, particularly for smaller companies.

As reported in the February 8, 2008 edition of *Corporate and Financial Weekly Digest*, the new rules adopted by the SEC earlier this year provide for online filing and simplification of Form D notices. Under the new rules, between September 15, 2008 and March 16, 2009, issuers may file a Form D either electronically or on paper. After March 16, 2009, electronic filing of a Form D will become mandatory. During this six-month "phase-in" period, issuers may file either the revised Form D (referred to as "Form D") or Temporary Form D (the old Form D with certain revisions). Both forms can be found at www.sec.gov/info/smallbus/cfformd.htm.

The SEC is encouraging Form D filers to use the voluntary system and inform SEC staff about their experiences. The SEC staff expects adjustments will be made to the system to increase its utility and user-friendliness before the online filing of Form D becomes mandatory. Filers can report their experiences to the SEC's Office of Small Business Policy in its Division of Corporation Finance at (202)551-3460 or smallbusiness@SEC.gov.

The SEC staff is continuing to work with the North American Securities Administrators Association to link its Form D filing system with a system built by state securities regulators that would accept state Form D filings. No timetable has been adopted for linking the two systems.

http://www.sec.gov/news/press/2008/2008-199.htm
http://www.sec.gov/rules/final/2008/33-8891.pdf

### RiskMetrics, ISS Parent, Recommends Against CVS Tender Offer for Longs

RiskMetrics Group, the parent of the proxy advisory service ISS, on September 12 recommended that shareholders of Longs Drug Stores not tender their shares in the tender offer launched by CVS. According to reports published by *MarketWatch* and *The Investor's Business Daily*, RiskMetrics was concerned primarily that "It does not appear that Longs made any attempt to play suitor against suitor. Longs appeared to place a priority on speed and certainty of closing." Additionally, the reports indicate that RiskMetrics was concerned that Longs' real estate portfolio was undervalued in the CVS offer.

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It is noteworthy that ISS has made a recommendation relating to a tender offer. ISS historically tended not to oppose M&A transactions, although in recent years it has become more vocal, especially in 2007 when it opposed Mitel Networks' offer for Inter-Tel in June, Eisner/Madison Dearborn's offer for Topps in August and URS' offer for Washington Group in August. However, these recommendations, and indeed most of ISS' advisory work, has related to shareholder voting scenarios, not tender offers. It is possible that RiskMetrics may have felt the CVS offer presented a uniquely compelling case to RiskMetrics. Nonetheless, market participants should be on the lookout for continuing active participation by RiskMetrics, which may attempt to leverage ISS' importance in proxy contests into new arenas.

http://www.marketwatch.com/News/Story/riskmetrics-advises-clients-against-cvs/story.aspx?guid=%7BEBC036F5-32E9-4FDD-9255-4E910A228175%7D&siteid=msn

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### Outside Consultant Held Primarily Liable for Securities Fraud in SEC Filings

The Tenth Circuit affirmed the grant of summary judgment in favor of the Securities and Exchange Commission in an enforcement action against a consultant and his consulting firm alleging violation of, among other provisions, Section 10(b) of the Securities and Exchange Act and Rule 10b-5 relating to material misstatements and omissions in a public company's SEC filings. The alleged fraud concerned the non-disclosure in SEC filings of (i) a stock sale agreement between the company and an offshore "boiler room" which allowed the boiler room to retain 70% of the sales proceeds, and (ii) the consultant's right to a finder's fee equal to 10% of the proceeds received by the company from the sales made by the boiler room.

In granting summary judgment to the SEC, the District Court ruled that the defendants could be held liable as primary violators of Section 10(b) and Rule 10b-5. On appeal, defendants argued that the ruling was mistaken because the SEC had only shown that the company, but not also the defendants, made the material misstatements or omissions underlying the SEC's claims.

In affirming the District Court's decision, the Tenth Circuit stated that the relevant question was whether the consultant, as a secondary actor (i.e., someone who did not sign or certify the filings), could fairly be said to have "made" the misrepresentations and whether he knew or should have known that such statements would reach investors. After rejecting a "brightline" requirement that misstatements be expressly "attributed" to a secondary actor for such an actor to be held primarily liable, the Tenth Circuit ruled that because (i) the consultant played an integral role in preparing the filings in issue, (ii) the documents were filed as drafted by the consultant, and (iii) the consultant was hired for the very purpose of preparing the filings and knew that they would be available to investors, the consultant could fairly be said to have caused the company to make the misstatements, and thus, could properly be held primarily liable. (*S.E.C. v. Wolfson*, No. 06-4035, 2008 WL 4053027 (10th Cir. Sept. 2, 2008))

### Complaint Failed to State Loss Causation

A federal district court dismissed a class action complaint brought by investors against China's largest insurance company and its officers and directors for violations of Section 10(b) of the Securities and Exchange Act. The lawsuit was brought on behalf of all investors who purchased the company's shares on the New York Stock Exchange and the Hong Kong Stock Exchange (HKSE) during the class period. Plaintiffs alleged that the company failed to disclose in its prospectus either an ongoing Chinese government audit or the Securities and Exchange Commission's investigation of the company's predecessor for alleged accounting irregularities. Plaintiffs claimed that these non-disclosures artificially inflated the company's stock and caused plaintiffs to suffer loss when the stock price dropped after the press released reports about the audit and investigation.

Defendants successfully moved to dismiss the complaint for failure to state a claim. The court ruled that in order to establish the loss causation element of their claim, plaintiffs were required to allege that the subject of the fraudulent statement caused the alleged loss "in the sense that the misstatement or omission concealed something from the market that, when disclosed or corrected, negatively affected the value of the security." The court found that plaintiffs had not met this standard because the disclosure of the government audit and SEC investigation did not result in the losses that plaintiffs sought to recover. To the contrary, the court found that the defendant company's stock price rose following disclosure of the Chinese government audit and dropped insignificantly after disclosure of the SEC investigation (and that plaintiffs had not claimed that this "minor price reduction" constituted their loss).

The court also granted defendants' motion to dismiss for lack of subject matter jurisdiction the claims of foreign purchasers who acquired stock on the HKSE. The court ruled that subject matter jurisdiction did not exist because plaintiffs failed to show either that the defendants' alleged activities in the United States directly caused losses to foreign purchasers or that defendants' conduct outside the United States had a "substantial" impact within the United States. (*In re China Life Securities Litig.*, No. 04-2112, 2008 WL 4066919 (S.D.N.Y. Sept. 3, 2008))

## Broker Dealer

### FINRA Changes Customer Complaint Reporting Procedures

Members of the Financial Industry Regulatory Authority (FINRA) are required, under NASD Rule 3070(c) and incorporated NYSE Rule 351(d), to report statistical and summary information regarding customer complaints. The reporting procedures require that the complaints be categorized using various problem and product codes (e.g., Code #62 is the "Online Trading" problem category). In order to better categorize complaints, FINRA has modified the customer complaint reporting procedures by adding and clarifying certain codes. The changes will become effective October 1 and must be reflected in the reporting for the fourth quarter of 2008.

http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p116986.pdf

### ISE Proposes to Allow Non-Displayed Penny Quotes and Orders in Certain Options

The International Securities Exchange, LLC (ISE) has filed with the Securities and Exchange Commission a proposed rule change which would allow non-displayed penny quotes and orders in options that trade in minimum pricing increments greater than one cent.

The SEC has approved similar rule changes with respect to the Nasdaq Options Exchange (Nasdaq) and the Chicago Board Options Exchange (CBOE), which similarly permit the entry of orders and quotes in penny increments in options series that have a minimum trading increment greater than one cent. Thus, the actual firm price of the order or quote is not displayed to market participants or the public and the penny price is temporarily hidden.

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The ISE's proposal would eliminate any competitive advantage that Nasdaq or CBOE members would have over members of ISE.

http://www.sec.gov/rules/sro/ise/2008/34-58486.pdf

## Structured Finance and Securitization

### IRS Investigates Undervaluing of Sponsor-Retained REMIC Regular Interests

For some time, tax practitioners and corporate tax compliance officers have been awaiting the announcement by the Large and Midsize Business Division of the Internal Revenue Service of its "Tier III" issues. Recently, the IRS released such a list. The IRS revealed, among other things, that it is looking into the issue of real estate mortgage investment conduit (REMIC) sponsors' understatement of reportable gain on the retention and sale of regular interests. Undervaluing REMIC regular interests retained by the sponsor for any given REMIC results in a higher relative allocation of the sponsor's tax basis to all the other REMIC regular interests it is selling, thereby deferring its taxable gain from the sale. IRS auditors will be reviewing the sponsor's economic models and assumptions (such as the loss rate, the prepayment rate, and the discount rate) used to value the REMIC interests in order to determine if the basis allocations are appropriate.

http://www.irs.gov/businesses/article/0,,id=180721,00.html

### New Jersey Governor Signs "Save New Jersey Homes Act of 2008"

On September 15, New Jersey Governor Jon Corzine signed into law the "Save New Jersey Homes Act of 2008." As reported in the June 27, 2008 edition of *Corporate and Financial Weekly Digest*, the legislation applies to certain hybrid mortgage loans that have an initial fixed-rate interest period of five years or less followed by an adjustable-rate interest period and that are secured by owner-occupied properties. The law requires creditors to notify eligible mortgagors prior to the first interest rate reset date, and prior to the commencement of foreclosure proceedings, of the mortgagor's rights under the law. After receipt of the notice, if the mortgagor certifies he or she is unable to make monthly payments at the fully-indexed mortgage rate, the mortgagor is entitled to an extension of three years, during which the interest rate payable on the mortgage loan is not allowed to increase above the introductory rate. A mortgagor forfeits the benefits of the law if the modified mortgage loan becomes 60 days or more delinquent, and all deferred interest must be repaid when the mortgage loan is ultimately repaid.

http://www.njleg.state.nj.us/2008/Bills/A3000/2780_R2.PDF

## CFTC

### CFTC Staff Releases Report on Commodity Swap Dealers and Index Traders

Late last week, the Commodity Futures Trading Commission released a staff report on its recent analysis of trading by commodity swap dealers and index traders. The report, based on information gathered through the CFTC's June 2008 special call, analyzes data from the period between December 31, 2007 through June 30, 2008. Among other findings noted in the report, the approximately 30% increase in the notional value of crude oil during the period studied appeared to be attributable entirely to the appreciation of existing investments, rather than increased commodity index investment. The staff found a net decline of equivalent long futures contracts over the same period.


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The staff report also makes several preliminary recommendations regarding ongoing monitoring and potential regulation of the activity of over-the-counter swap dealers and commodity index traders, including the creation of a new swap dealer classification for inclusion in the CFTC's Commitments of Traders Reports, as well as the publication of a new periodic supplemental report on swap dealer activity. The report also suggests the potential elimination of the bona fide hedge exemption for swap dealers and its replacement with a more limited "risk management" exemption.

http://www.cftc.gov/newsroom/generalpressreleases/2008/pr5542-08.html
http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf

**CFTC Seeks Comments on Proposed Revisions to JAC Operating Agreement**

The Commodity Futures Trading Commission has published for comment proposed revisions to the operating agreement of the Joint Audit Committee (JAC), composed of surveillance staff from various futures exchanges and the National Futures Association. Previous amendments were proposed to the JAC's operating agreement in 2004, but were never adopted. The newly proposed amendments, available from the CFTC's Office of the Secretariat, include changes to JAC governance procedures, membership criteria and information-sharing arrangements, as well as the criteria for designation as a designated self-regulatory organization.

The comment period for the proposed amendments closes on October 14.

http://www.cftc.gov/stellent/groups/public/@lrfederalregister/documents/file/e8-21114a.pdf

## Banking

**Banking Agencies Propose Changes to Accounting Treatment of Goodwill**

On September 15, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (collectively, Banking Agencies) issued a proposed rule that would permit banks, holding companies and savings associations to reduce the amount of goodwill that a banking organization must deduct from tier 1 capital by the amount of any deferred tax liability associated with that goodwill (Proposed Rule). A banking organization that reduces the amount of goodwill deducted from tier 1 capital by the amount of the associated deferred tax liability would not, however, be permitted to net this deferred tax liability against deferred tax assets when determining regulatory capital limitations on deferred tax assets.

According to the commentary in the Proposed Rule, this change "would effectively reduce the amount of goodwill that a banking organization must deduct from Tier 1 capital and would reflect a banking organization's maximum exposure to loss in the event that such goodwill is impaired or derecognized for financial reporting purposes."

The Proposed Rule notes that its issuance resulted from several requests made to the Banking Agencies to permit the amount of goodwill arising from a taxable business combination that must be deducted from tier 1 capital to be reduced by any associated deferred tax liability. Upon review of the proposal, many in the banking industry believe the Proposed Rule's adoption could help revive banking mergers and acquisitions.


**BANKING**

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Comments on the Proposed Rule are due 30 days from the date of publication in the Federal Register.

http://federalreserve.gov/newsevents/press/bcreg/20080915a.htm

**Injections of Liquidity into World Capital Markets by Central Bankers**

On September 18, the Bank of Canada, the Bank of England, the European Central Bank (ECB), the Federal Reserve, the Bank of Japan, and the Swiss National Bank announced coordinated measures designed to address the continued elevated pressures in U.S. dollar short-term funding markets. These measures, together with other actions taken in the last few days by individual central banks, are designed to improve the liquidity conditions in global financial markets. According to a press release issued by the Federal Reserve, "the central banks continue to work together closely and will take appropriate steps to address the ongoing pressures."

Yesterday's actions taken by the Federal Reserve include the following:

The Federal Open Market Committee (FOMC) has authorized a $180 billion expansion of its temporary reciprocal currency arrangements (swap lines). This increased capacity will be available to provide dollar funding for both term and overnight liquidity operations by the other central banks.

The FOMC has authorized increases in the existing swap lines with the ECB and the Swiss National Bank. These larger facilities will now support the provision of U.S. dollar liquidity in amounts of up to $110 billion by the ECB, an increase of $55 billion, and up to $27 billion by the Swiss National Bank, an increase of $15 billion.

In addition, new swap facilities have been authorized with the Bank of Japan, the Bank of England, and the Bank of Canada. These facilities will support the provision of U.S. dollar liquidity in amounts of up to $60 billion by the Bank of Japan, $40 billion by the Bank of England, and $10 billion by the Bank of Canada.

All of these reciprocal currency arrangements have been authorized through January 30, 2009.

http://www.federalreserve.gov/newsevents/press/monetary/20080918a.htm

Information on the actions that will be taken by other central banks is available at the following websites:

Bank of Canada
Bank of England
European Central Bank
Bank of Japan
Swiss National Bank

**OTS Issues New Guidance on One- to Four-Family Home Loans; Loans for Sale Will Receive More Scrutiny if They Exceed Tier 1 Capital**

In a move that seems designed to protect savings institutions that sell home loans, the Office of Thrift Supervision (OTS) has issued revised guidance to its regulatees with respect to making home loans, especially those that are destined to be sold in the secondary market, including to government-sponsored entities. In Regulatory Bulletin 37-24, the OTS refined the guidance that it issued in March 2007 (Regulatory Bulletin 37-18) to make clear that "it has been and remains OTS policy that savings associations use prudent underwriting and documentation standards for all loans they originate, both for those to be held in portfolio and those originated for sale."

In the new bulletin the OTS reminds savings institutions that they are exposed to risk on loans sold to the extent that such loans may be "put back" to the institution. For example, many contracts between selling institutions and buyers provide that if the loan defaults within 120 days, the buyer may "put back" the loan to the seller. Other "put back" remedies may also apply depending on the provisions of the contract between the selling institution and the buyer.

It does appear, however, that institutions do not have to use precisely the same underwriting standards for loans for portfolio versus loans intended to be sold. Thus the OTS stated that "OTS expects that loans originated for sale will be underwritten to comply with both the institution's Board-approved loan policies *for such programs* and with all existing regulations and supervisory guidance governing the documentation and underwriting standards for residential mortgages." (Emphasis added.) The upshot appears to be that the standards may differ as long as "existing regulations and supervisory guidance" are followed. The concern appears to be that institutions not be caught with unacceptable loans in the event that their pipeline becomes unsaleable.

OTS stated that "experience has shown that the level of pipeline, warehouse, and credit-enhancing repurchase exposure for mortgage loans originated for sale to non-government sponsored enterprise purchasers can constitute a concentration risk.... Given the concentration risk, the Board-approved loan policy should establish a limit for aggregate pipeline, warehouse, and credit-enhancing repurchase exposure from such lending programs. A savings association will receive closer supervisory review of its concentration risk when such exposure exceeds its Tier 1 capital."

http://files.ots.treas.gov/748401.pdf

## UK Developments

**FSA Prohibits Short Positions in Financial Stocks**

On September 18, the UK Financial Services Authority (FSA) announced the introduction of new provisions in its Code of Market Conduct that prohibit the active creation or increase of net short positions in publicly quoted financial companies. The provisions came into effect at midnight on September 18.

Effective Tuesday, September 23, the FSA will also require daily disclosure of all net short positions in excess of 0.25% of the ordinary share capital of the relevant companies held at market close on the previous working day. Disclosure of such positions held at close on Friday, September 19 will be required on September 23. The FSA announcement is not explicit on this point, but it is our understanding that disclosure of positions must be effected by means of a Regulatory Information Service as this is the required disclosure method under the FSA's current short selling disclosure requirements which apply to short positions in stocks undertaking rights issues.

Failure to give the required disclosure will constitute market abuse under the FSA's Code of Market Conduct, which applies to all market participants, not just to FSA-regulated firms.

The FSA has not yet published detailed changes to the Code of Market Conduct, nor has it published a list of the companies whose securities are covered by the new rules. The FSA is expected to publish both before the market opens on September 19.

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The FSA stated that it "stands ready to extend this approach to other sectors if it judges it to be necessary."

The provisions will remain in force until January 16, 2009, although they will be reviewed after 30 days. The FSA has promised that a comprehensive review of its rules on short selling will be published in January 2009.

www.fsa.gov.uk/pages/Library/Communication/PR/2008/102.shtml

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

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