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Corporate and Financial Weekly Digest

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SEC/Corporate

Panel Opposes SEC Proposal to Drop Reconciliation for IFRS Filers

In a letter dated August 31, the Investors Technical Advisory Committee of the Financial Accounting Standards Board urged the Securities and Exchange Commission to revise or abandon a proposed rule change issued by the SEC on July 2 eliminating the requirement that foreign private issuers reconcile financial statements filed with the SEC in accordance with the International Financial Reporting Standards as published by the International Accounting Standards Board to U.S. generally accepted accounting principles.

Even though a number of members of the ITAC have supported harmonizing U.S. and other national accounting standards with a set of high quality comprehensive rules issued by the IASB, the ITAC suggests in its letter that eliminating the reconciliation requirements would actually undercut efforts to achieve convergence between the different accounting standards. Specifically, the ITAC stated several reasons for the SEC to revise or abandon the proposed rule change including statements that:

- "there remain many highly material differences in the results produced by the two systems" and "in the absence of the required reconciliation, those important differences generally could not be quantified or even reasonably estimated";
- The ITAC would prefer to see "concrete evidence that the two sets of standards are substantially equivalent before the reconciliation is eliminated"; and
- The ITAC, along with its concerns about differences in accounting standards, is "not yet certain that there is consistent auditing and enforcement of the application of IFRS" noting lack of widespread familiarity with international accounting rules both in the auditing profession and among the staff at the SEC.

While the ITAC opposes the proposed rule change, U.S. and foreign companies are expected to voice general support for the proposal to eliminate the reconciliation requirement.

Companies and individuals have until September 24 to comment on the proposed rule change. (*Securities Regulation and Law*, 9/17/07, Vol 39, p. 1414)

http://www.sec.gov/comments/s7-13-07/s71307-16.pdf

SEC/CORPORATE

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GAO Critiques SEC's Enforcement Division

On August 15, the Government Accountability Office issued a report citing weaknesses in the Securities and Exchange Commission's Enforcement Division's systems and procedures for planning, tracking and closing investigations. The result has been a backlog of investigations which the SEC is no longer pursuing with potentially negative consequences for those individuals and companies suspected of committing securities violations. The GAO's report was also critical of the Enforcement Division's distribution of settlement funds (Fair Fund) to harmed investors, noting that of $8.4 billion of such funds ordered to be distributed since 2002, only $1.8 billion had been received by harmed investors.

The GAO's report recommended that the SEC take the following actions to remedy the deficiencies outlined in its report:

- establish written policies and criteria for reviewing and approving new investigations;
- establish controls to better ensure the reliability of investigative data entered into the Enforcement Division's information technology systems;
- consider developing expedited procedures for closing investigations; and
- establish a plan to staff and identify the roles and responsibilities of the SEC's new Fair Fund program office and to collect and analyze reports on completed Fair Fund plans.

http://www.gao.gov/new.items/d07830.pdf

Broker Dealer

Amex Creates New Class of Off-Floor Market Makers

The Securities and Exchange Commission has approved a proposal by the American Stock Exchange to create a new class of off-floor market makers called "Designated Amex Remote Traders" (DARTs) in all ETF and equity securities traded on Amex. DARTs are Amex members or member organizations that enter electronic quotes into Amex's AEMI platform on a regular basis in all securities to which they are assigned in the DART program. An Amex specialist firm may also become a DART, but may not be registered as a DART in securities in which it is also a specialist. DARTs will be required to satisfy eligibility criteria similar to those applicable to the Supplemental Registered Options Traders program, including adequacy of resources, a history of stability and operational capacity, the existence of order flow commitments and the ability to interact with order flow in all types of markets.

In addition, Amex will establish minimum requirements applicable to DARTs, which will include performance standards, including that a DART's quotations must be on one side of the NBBO for a required percentage of time in all of its assigned securities. DARTs who fail to comply with such requirements may lose certain benefits to which they would otherwise be entitled (such as rebates for providing liquidity), including the potential loss or suspension of their DART status.

http://www.sec.gov/rules/sro/amex/2007/34-56446.pdf

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Pre and Post Market Trade Through Restrictions on IOC Cross Orders Removed

The Securities and Exchange Commission has approved the Philadelphia Stock Exchange's (Phlx) proposal to remove the trade through restrictions on IOC Cross Orders entered during the Pre Market or Post Market sessions on Phlx's electronic trading platform, XLE. XLE accepts IOC Cross Orders during all three of its trading sessions, which collectively run from 8:00 a.m. to 6:00 p.m. Previously, XLE had permitted IOC Cross Orders to trade through the Protected NBBO in only four circumstances, each of which coincided with an exception to, or exemption from, Regulation NMS. Under the newly amended rules, IOC Cross Orders on XLE also are permitted to trade through the Protected NBBO during the Pre Market and Post Market sessions, as those sessions fall outside of "regular trading hours" as defined in Regulation NMS (currently between 9:30 a.m. and 4:00 p.m. ET) and therefore such trade throughs would not contravene the Order Protection Rule.

http://www.sec.gov/rules/sro/phlx/2007/34-56443.pdf

Banking

Banking Agencies Request Comment Regarding Garnishment Orders

On September 19, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision and the National Credit Union Administration (collectively, the Banking Agencies) issued a proposed statement encouraging the financial institutions they regulate to follow "best practices" to protect federal benefit payments (such as Social Security benefits, Supplemental Security Income benefits, veterans' benefits, etc.) from garnishment orders and the claims of judgment creditors (the Proposed Statement).

According to the Banking Agencies, federal benefit payments often account for a large part of a recipient's income and the recipient of such funds often faces significant difficulties when an institution, pursuant to a court order, places a freeze on a consumer's account which contains such funds. The development of the Proposed Statement, however, is intended to "encourage financial institutions to minimize the hardships encountered by federal benefit funds recipients and to do so while remaining in compliance with applicable law." Comments are invited and are due 60 days after publication of the Proposed Statement in the *Federal Register*.

http://www.fdic.gov/news/news/press/2007/pr07078.html

United Kingdom Developments

Information Memorandum on Conflicts of Interest Obligations Published

On September 13, the industry group, MiFID Connect, published an information memorandum on the conflicts of interest requirements that will be imposed by the UK Financial Services Authority (FSA) from November 1. These requirements are to be created as part of the UK implementation of the EU's Markets in Financial Instruments Directive (MiFID) and Capital Requirements Directive.

The guidance focuses on aspects of FSA's Senior Management Arrangements, Systems and Controls sourcebook and includes suggested measures and commentaries to assist firms in implementing processes and procedures enable them to identify and manage conflicts of interest.

BANKING

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The information memorandum has not been formally recognized by the FSA.

http://www.mifidconnect.org/content/1/c6/01/06/90/conflicts_of_interest_memo.pdf

Litigation

Court Holds That Issue of Arbitrability Is to Be Decided by Arbitrator

Plaintiff sued in court to compel defendant to proceed with the arbitration of claims that plaintiff asserted in an arbitration. Granting defendant's motion to dismiss, the District Court for the Northern District of Ohio held that whether plaintiff's claims were arbitrable was a question for the arbitrator, not the Court, to decide. An arbitration clause in a contract between the parties provided that any dispute concerning the contract would be settled by an arbitration conducted pursuant to the Rules of the International Chamber of Commerce (ICC). The plaintiff filed its lawsuit in response to the defendant's application in the arbitration to dismiss the plaintiff's claims on the grounds that the defendant had never consented to arbitrate such claims.

Claiming that defendant's motion before the arbitrator was tantamount to a refusal to arbitrate, plaintiff petitioned the District Court to compel defendant, pursuant to Section 4 of the Federal Arbitration Act (FAA), to arbitrate the claims. Rejecting the plaintiff's argument, the District Court held, among other things, that the parties had unmistakably agreed to refer issues of arbitrability to the arbitrator because the ICC's Rules – which the parties provided would govern the arbitration – expressly empowered the arbitrator to determine whether a dispute falls within the scope of an agreement to arbitrate. Because the issue of arbitrability was within the exclusive domain of the arbitrator, the defendant's challenge to the arbitrability of the claims was not "a refusal to arbitrate" within the meaning of the FAA. (*Warren Steel Holdings LLC v. Williams*, 2007 WL 2688240 (N.D. Ohio Sept. 11, 2007))

Third Circuit Court of Appeals Affirms Dismissal of Securities Fraud Claim

Affirming the District Court's decision to grant defendants' motion to dismiss plaintiffs' securities fraud claims, the Third Circuit Court of Appeals held that plaintiffs did not meet the heightened pleading standards of the Private Securities Litigation Reform Act (PSLRA) because they failed to allege specific facts demonstrating that defendants acted with scienter, *i.e.*, by setting forth facts showing either (i) motive and opportunity to commit fraud, or (ii) strong circumstantial evidence of conscious misbehavior or recklessness.

Plaintiffs claimed that defendants knowingly falsified and inflated the earnings reported by the defendant company in order to preserve the company's credit line. After noting that the complaint set out nothing more than an ordinary business motive (i.e., preservation of credit) and that such motivations were "typically insufficient to support a strong inference of fraud," the Third Circuit found that plaintiffs' bald allegations, which failed to specify which financial figures were manipulated or when defendants knew of or implemented the fraud, were insufficient. The Court explained that the mere misstatement of financial earnings coupled with only generalized allegations of motive and intent are not grounds upon which fraud can be inferred under the PSLRA. (*Key Equities Investors, Inc. v. Sel-Leb Marketing, Inc.*, 2007 WL 2510385 (3d Cir. Sept. 6, 2007))

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CFTC

Interpretive Notice Regarding Misuse of Trade Secrets and Proprietary Information Issued

National Futures Association (NFA) Compliance Rule 2-4 requires members and associates to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their commodity futures business. NFA's Board of Directors has issued an Interpretive Notice to Compliance Rule 2-4, which became effective on September 5. The Notice reiterates that Compliance Rule 2-4 prohibits members and associates from knowingly obtaining or seeking to obtain another member's or associate's confidential information or trade secrets without that person's permission. It also prohibits members and associates from knowingly or recklessly misusing confidential information or trade secrets in their possession, and provides the following three examples of behavior that violates the rule: (i) misusing customer information; (ii) disclosing customer orders prior to execution, except as permitted by exchange rules; and (iii) obtaining or attempting to obtain information that discloses a trading advisor's historical trading positions.

http://www.nfa.futures.org/nfaManual/manualInterp.asp#61

http://www.nfa.futures.org/news/newsProposedRule.asp?ArticleID=1926

CFTC Hearing on Oversight of Regulated Futures Exchanges and ECMs

The Commodity Futures Trading Commission held a hearing on September 18 to examine the oversight of trading on regulated futures exchanges and exempt commercial markets. The hearing was held to elicit views from industry participants regarding regulation of the energy markets, including such topics as price manipulation and other disruptions to market integrity. Links to CFTC Commissioners' and staff's prepared remarks are set forth below.

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opasommers-1.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opachilton-1.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opadunn-9.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opalukken-28.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opafenton_091807.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opashilts_091807.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opaharris_091807.pdf

http://www.cftc.gov/stellent/groups/public/@newsroom/documents/speechandtestimony/opaarbit_091807.pdf

CFTC

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