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Corporate and Financial Weekly Digest

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SEC/Corporate

SEC Critiques Companies' Executive Compensation Disclosure

According to the *Wall Street Journal* and other sources, the Securities and Exchange Commission has been sending out comment letters covering companies' compliance with the SEC's new executive compensation disclosure rules. Presumably to underscore the importance the SEC attaches to these disclosure requirements, the letters were addressed to each company's Chief Executive Officer. A significant number of companies received the SEC staff comments in the last week of August, with as many as 300 companies expected to receive SEC staff comments over the next few weeks. In the SEC staff comment letters, companies were typically asked to:

- Disclose specific performance targets and benchmarks for performance-based plans or provide a detailed explanation as to why disclosing targets would cause competitive harm.
- Clarify whether the board or compensation committee exercised positive or negative discretion to increase or decrease awards under performance target plans.
- Identify companies that comprise peer groups and survey sources for "benchmarking" purposes.
- Analyze the reasons for the significant disparity in the amount of compensation awarded to the CEO vs. other named executive officers.
- Describe how the company decides what multiples of pay to provide under various circumstances (e.g. change in control, other severance) and to what pay elements those multiples are applied (e.g. salary, bonus, benefits).
- Discuss how the different elements of compensation are determined and whether the amounts paid under one element affects amounts paid under others.
- Discuss the role of executive officers in determining or recommending the amount or form of executive and director compensation, including how much input the CEO had in developing compensation packages and whether the CEO had the ability to call or attend compensation committee meetings and/or meet with the committee's compensation consultant.

SEC/CORPORATE

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- Provide a description of the nature and scope of the compensation consultant's assignment, including the material elements of the instructions or directions given to the consultant with respect to the performance of its duties under the engagement.

Companies are generally given one month to respond to the comment letters. The comment letters require the provision of additional information to the SEC as to some matters but as to most matters appear to permit disclosure in the company's next proxy statement.

The SEC plans to issue a more general release later this year that will summarize its key observations on companies' proxy disclosures under the new SEC rules. (*Wall Street Journal*, B1, 8/31/07)

Broker Dealer

Compliance Date Extended for New Program Trading Reporting Obligations

The New York Stock Exchange has extended the compliance dates for its revisions to NYSE Rule 80A, regarding "Program Trading." These changes redefined two of the existing Program Trading related audit trail account types (J and K) and eliminated the requirement that firms submit Daily Program Trading Reports (DPTRs), and were described in NYSE Regulation Information Memo 07-52. The NYSE has set an initial a compliance date of September 30, 2007 for use of the redefined account types and cessation of the DPTR requirement. However, NYSE has now extended this deadline until January 31, 2008. In the meantime, firms must continue to submit their DPTR in accordance with the current requirements.

http://apps.nyse.com/commdata/PubInfoMemos.nsf/AllPublishedInfoMemosNyseCom/85256FCB005E19E8852573480067C299/$FILE/Microsoft%20Word%20-%20Document%20in%2007-88.pdf

Expansion of Delta Hedging Position Limit Exemption Proposed

The Financial Industry Regulatory Authority (FINRA) has filed proposed rule changes with the Securities and Exchange Commission to expand the availability of the "delta hedging" exemption from equity options position limits. "Delta hedging" refers to the common practice of hedging an options position with shares of the underlying stock at less than a one-to-one ratio, based on the relative sensitivity of the value of the option contract as compared to the price of the underlying stock The exemption, which was previously available only to SEC-approved "OTC Derivatives Dealers" under NASD Rule 2860, exempts from FINRA's equity options position limits positions in standardized and/or conventional options that are hedged on a "delta neutral" basis.

Under the expanded exemption, any FINRA member, certain of their non-member affiliates, and certain other financial institutions may rely on the exemption with respect to their equity options positions in conventional or standardized options that are delta neutral under a "Permitted Pricing Model," as defined in the rule. "Permitted Pricing Models" generally include proprietary models employed by certain broker-dealers and financial institutions that are otherwise subject to federal regulation and oversight, as well as the delta model developed by The Options Clearing Corporation. The proposed rule also sets out modified reporting requirements and standards for disaggregation relief with respect to delta hedged positions.

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In addition to the FINRA proposal, the Chicago Board Options Exchange has submitted conforming amendments to its rulebook for SEC approval.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-15723.pdf

http://www.cboe.org/publish/RuleFilingsSEC/SR-CBOE-2007-099.pdf

FINRA Proposes Amended Price Improvement Requirements

The Financial Industry Regulatory Authority has filed proposed rule changes with the Securities and Exchange Commission that would modify the minimum price improvement that a member must provide in order to trade ahead of an unexecuted customer limit order. First, with respect to securities trading below $.01, the proposal would establish three sub-penny tiers (specifically, for orders priced (i) less than $.01 to $.0001, (ii) less than $.0001 to $.00001, and (iii) less than $.00001) and would generally require a minimum price improvement equal to the lesser of the lowest value in the applicable tier (for example, $.0001 for orders priced less than $.01 but equal to or greater than $.0001, except that the applicable value for orders priced less than $.00001 would be $.000001) or one-half of the current inside spread.

In addition, the proposal would add an alternative measure based on inside spread for limit orders priced over $1.00 (that is, the minimum amount of price improvement required would be the lesser of $.01 or one-half of the current inside spread). Finally, where the customer limit order is priced outside the inside market, the minimum price improvement must either satisfy the price improvement standards otherwise applicable to orders at that price or the member must trade at a price at or inside the best inside market.

The comment period for the proposal closes on September 18.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-16955.pdf

Amex Establishes Directed Order Program

The Securities and Exchange Commission has approved a proposal submitted by the American Stock Exchange to establish a directed order program. Under the Amex directed order program, qualifying specialists, Registered Options Traders, Supplemental Registered Options Traders, and Remote Registered Options Traders may receive directed orders from Amex members who submit, as agent, customer orders to Amex (Order Flow Providers). In general, the program would provide an enhanced participation to the recipient of the directed order if such recipient (i) submits quotes electronically through Amex's ANTE system in the options classes in which it is assigned, (ii) complies with its Amex quoting obligations and provides continuous two-sided quotations for no less than 100% of the series of each class for which it receives directed orders, and (iii) is quoting at the best bid or offer on Amex at the time the directed order is received.

http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/E7-16468.pdf

Extension and Expansion of Options Penny Pilot Proposed

The U.S. options exchanges, the Chicago Board Options Exchange, the American Stock Exchange, NYSE Arca, the International Securities Exchange, the Boston Options Exchange and the Philadelphia Stock

Exchange, have all submitted rule changes to the Securities and Exchange Commission proposing the extension of their "penny pilot" programs, as well as a two-phase expansion of the program to include fifty additional options series between September 28, 2007 and March 27, 2009. The industry-wide penny pilot program currently permits thirteen options series to be quoted and traded in increments of $.01, and is scheduled to expire on September 27, 2007.

http://www.sec.gov/rules/sro/amex/2007/34-56307.pdf

http://www.sec.gov/rules/sro/bse/2007/34-56253.pdf

http://www.sec.gov/rules/sro/cboe/2007/34-56276.pdf

http://www.sec.gov/rules/sro/ise/2007/34-56306.pdf

http://www.sec.gov/rules/sro/nysearca/2007/34-56280.pdf

http://www.sec.gov/rules/sro/phlx/2007/34-56284.pdf

Banking

Statement Issued on Loss Mitigation Strategies for Servicers of Residential Mortgages

The federal financial regulatory agencies and the Conference of State Bank Supervisors (CSBS) on September 4, issued a statement encouraging federally regulated financial institutions and state-supervised entities that service securitized residential mortgages to review to determine the full extent of their authority under pooling and servicing agreements to identify borrowers at risk of default and pursue appropriate loss mitigation strategies designed to preserve home ownership.

Significant numbers of hybrid adjustable-rate mortgages will reset throughout the remainder of this year and next. Many subprime and other mortgage loans have been transferred into securitization trusts that are governed by pooling and servicing agreements. These agreements may allow servicers to contact borrowers at risk of default, assess whether default is reasonably foreseeable, and, if so, apply loss mitigation strategies designed to achieve sustainable mortgage obligations. Servicers may have the flexibility to contact borrowers in advance of loan resets.

Appropriate loss mitigation strategies may include, for example, loan modifications, conversion of an adjustable rate mortgage into a fixed rate, deferral of payments, or extending amortization. In addition, institutions should consider referring appropriate borrowers to qualified homeownership counseling services that may be able to work with all parties to avoid unnecessary foreclosures.

A link to the statement, which was issued by 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, the National Credit Union Administration, and CSBS, is provided below.

http://www.fdic.gov/news/news/press/2007/pr07073a.html

Bulletin Issued to National Banks Regarding Political Contributions

The Office of the Comptroller of the Currency (OCC), after consultation with

BANKING

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the Federal Election Commission (FEC), prepared guidance to describe and to emphasize the prohibitions on political contributions or expenditures by national banks pursuant to the Federal Election Campaign Act of 1971, as amended, 2 USC § 441b (the Act). The bulletin replaces OCC Bulletin 2000-8 (March 22, 2000).

The Act makes it unlawful for a national bank to make any contribution or expenditure or to provide any service (except usual and customary banking services) or anything of value in connection with any election to any political office, or in connection with any primary election or political convention or caucus held to select candidates for any political office. This prohibition applies to all federal, state, and local elections, political conventions, and caucuses. 11 CFR § 114.2(a). In addition, it is unlawful for any officer or any director of a national bank to consent on behalf of the bank to any political contribution or expenditure prohibited by the Act, and it is unlawful for any candidate, political committee, or other person to knowingly accept or receive a political contribution or expenditure prohibited by the Act. 2 USC § 441b.

FEC Regulations prohibit other forms of political contributions or expenditures by national banks, including, but not limited to, the purchase of tickets to political dinners or other political fundraising events, advertisements in political literature, and donations of goods or services in connection with political fundraising events and activities. 11 CFR §§ 100.51-100.57 and 114.2. However, bank employees, in their personal capacity, may make contributions from their own funds. Also, a national bank is not prohibited under the Act from making a contribution to a fund whose purpose is to influence a ballot referendum, provided the referendum does not involve elections to any political office.

The Act requires that every political committee designate at least one insured depository institution as its campaign depository where all receipts are deposited and from which all significant disbursements are made. 2 U.S.C. § 432(h). National banks may serve as those depositories for political committees and may pay interest and dividends, in the regular course of business, on funds in such accounts. Fees for banking services may be waived or discounted, provided that such concessions are offered to others on equal terms and are a normal business practice.

http://www.occ.treas.gov/ftp/bulletin/2007-31.html

Litigation

SEC Met Burden for Contempt Order Against Defendants

The Securities and Exchange Commission sought to have defendants held in civil contempt for repeatedly violating a court order (the Order) that enjoined defendants from, among other things, selling unregistered securities and violating Rule 10b-5 of the Exchange Act. After noting that the SEC was required to show that (i) the Order was clear and unambiguous;(ii) the proof of defendants' noncompliance was clear and convincing; and (iii) the defendants had not attempted to comply in a reasonable manner, the Court ruled that the SEC had satisfied its burden.

Among other things, the SEC provided evidence that the defendants had issued billions of unregistered shares of stock in exchange for services after the Order was entered. Defendants admitted issuing the shares, but argued that they did not constitute "sales" because they were exchanged for services rather than cash. The court rejected the argument, finding that the Securities Act of 1933 defines "sale" broadly and clearly includes exchanges of unregistered securities for services. The SEC also provided evidence that

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defendants continued to make false statements in filings made with the SEC after the Order was entered. In a novel, yet unsurprisingly unavailing argument, defendants asserted that it was a matter of "widespread public knowledge" that these statements were false. However, far from "neutralizing" the impact of their false representations, the Court viewed defendants' admission as "demonstrat[ing] the brazenness of [their] mendacity." (*Securities Exchange Commission v. Universal Express, Inc.*, 2007 WL 2469452 (Aug. 31, 2007 S.D.N.Y.))

Issue of Fact Regarding Scienter Prevented Grant of Summary Judgment to Defendants

The District Court denied in part a motion for summary judgment in which defendants (a public company and individual officers and directors) in a class action lawsuit challenged the plaintiffs' ability to demonstrate that defendants acted with the requisite scienter to support its claims under Section 10(b) of the Securities Exchange Act of 1934. The plaintiffs asserted that defendants made numerous false and misleading statements regarding, among other things, demand for its products and anticipated revenues. Plaintiffs supported their showing of scienter with evidence that the individual defendants sold hundreds of millions of dollars worth of stock during the class period and that defendants knew of declining demand for the company's products during such period.

The Court first applied the Ninth Circuit's three factor test to evaluate whether defendants' stock sales supported plaintiffs' claim of scienter. This test required the Court to consider (i) the amount and percentage of shares sold, (ii) the timing of the sales, and (iii) consistency of the sales with prior trading history. The Court found that, standing alone, defendants' stock sales did not create a triable question of fact. It ruled, however, that the level of defendants' sales combined with (i) defendants' allegedly misleading statements prior to such sales; and (ii) evidence that defendants sought to increase projections at a time when they knew demand for their products was declining, inventory was increasing, and other adverse conditions existed was sufficient to create a triable question of fact with respect to whether defendants had acted with scienter. (*In re JDS Uniphase Corp. Securities Litigation*, 2007 WL 2429593 (N.D.Cal. Aug. 24, 2007))

CFTC

Application of the Correspondent Account Rule to OTC Executing Dealers

The Financial Crimes Enforcement Network (FinCEN) has issued interpretive guidance to clarify the due diligence obligations of executing dealers in over-the-counter foreign exchange and derivatives markets pursuant to prime brokerage arrangements under the correspondent account provisions of the USA PATRIOT Act. The correspondent account rule applies to correspondent accounts that are established, maintained, administered or managed by a covered financial institution for a foreign financial institution. The guidance indicates that FinCEN does not view the interaction between an executing dealer and a prime brokerage client as the establishment, maintenance, administration or management of a correspondent account for the prime brokerage client that would require an executing dealer to comply with the due diligence provisions of the correspondent account rule.

http://www.fincen.gov/312ForexOTCPrimeBrokerage.pdf

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Amendments Made to NFA Interpretive Notice Regarding Enhanced Supervisory Requirements

The Commodity Futures Trading Commission has approved revisions to a National Futures Association (NFA) Interpretive Notice relating to enhanced supervisory procedures for NFA member firms whose employees or principals previously worked for firms that were sanctioned by the CFTC or NFA because of their sales practices. The amendments to the Interpretive Notice (i) expand the definition of a Disciplined Firm to include firms that have been sanctioned by the CFTC or NFA during the preceding five years for using deceptive telemarketing practices or promotional material, even if the firm was not barred from the industry and (ii) require firms that charge 50% or more of their customers round-turn commissions, fees and other charges that total $100 or more per futures, forex or option contract to, among other things, tape record telephone calls between the member's with both existing and potential customers, submit all promotional material to NFA at least 10 days prior to first use, adopt written supervisory procedures, make quarterly reports of its compliance with these requirements, and either operate pursuant to a guarantee agreement or maintain an increased level of adjusted net capital.

http://www.nfa.futures.org/news/newsProposedRule.asp?ArticleID=1782
http://www.nfa.futures.org/news/newsNotice.asp?ArticleID=1943

No-Action Relief Issued on Regulation 1.65 (Transfer of Accounts)

The Division of Clearing and Intermediary Oversight (DCIO) of the Commodity Futures Trading Commission granted no-action relief from the customer consent requirements of Regulation 1.65(a) (notice of bulk transfers and disclosure obligations to customers) to a transferee firm where the transferor firm was believed to be undercapitalized. DCIO stated that, because of the exigent circumstances, granting relief would not be contrary to the public interest. Among other requirements, Regulation 1.65(a) provides that, prior to transferring a customer account to another futures commission merchant or introducing broker other than at the request of the customer, a futures commission merchant or introducing broker must obtain the customer's specific consent to the transfer. In its no-action letter, DCIO noted that the CFTC recognized when it adopted Regulation 1.65(a) that the normal ten-business-day advance notice of bulk transfers would not be applicable in a financial emergency.

http://www.cftc.gov/stellent/groups/public/@documents07/documents/letter/07-15.pdf

DCIO Issues Advisory on Forex Transactions

The Division of Clearing and Intermediary Oversight (DCIO) of the Commodity Futures Trading Commission has issued an Advisory concerning retail off-exchange foreign currency futures and option transactions. Among other things, the Advisory addresses (i) registration requirements for associated persons of firms that are involved in forex transactions and persons acting as introducing brokers (IBs), commodity trading advisors, or commodity pool operators; (ii) the circumstances in which unregistered affiliates of a futures commission merchant (FCM) may act as counterparties in forex transactions; (iii) the "segregation" of forex customer funds; (iv) introducing entities acting as FCMs; (v) the applicability of the CFTC's form of IB Guarantee Agreement to forex transactions, and (vi) the inclusion of

statements from an FCM's unregistered affiliate in the FCM's account statements to its customers.

http://www.cftc.gov/stellent/groups/public/@cpfraudawarenessandprotection/documents/file/forex_advretailcustomers2007.pdf

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