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Corporate and Financial Weekly Digest

November 21, 2008

From the Editor

Please note that *Corporate and Financial Weekly Digest* will not be published next Friday, November 28, due to the Thanksgiving holiday. The next issue will be distributed on December 5.

SEC/Corporate

SEC Proposes Roadmap for Use of Financial Statements Prepared in Accordance with IFRS

The Securities and Exchange Commission has proposed a roadmap for the use of financial statements prepared in accordance with International Financing Reporting Standards (IFRS) in connection with SEC filings by public companies.

The proposed roadmap addresses the basis for considering the mandatory use of IFRS by U.S. issuers, setting forth seven milestones which, if achieved, could lead to the mandatory use of IFRS by U.S. issuers in their filings with the SEC. These milestones include improvements in accounting standards, accountability and funding of the IASC Foundation (which oversees the major standard-setter for IFRS), improvement in the ability to use interactive data for IFRS reporting, and education and training relating to IFRS. In 2011 the SEC would determine whether to proceed with rulemaking to require that U.S. issuers use IFRS beginning in 2014 based upon an evaluation of the progress with respect to these milestones at that time.

The SEC has long expressed its support for a single set of high-quality global accounting standards as an important means of enhancing the comparability of U.S. companies with that of non-U.S. companies. In the view of the SEC, the increasing acceptance and use of IFRS in major capital markets throughout the world over the past several years, and their anticipated use in other countries in the near future, indicate that IFRS have the potential to become the set of accounting standards that best provide a common platform for company financial reporting. Approximately 113 countries around the world currently require or permit IFRS reporting for domestic, listed companies.

The SEC also proposed to permit early use of IFRS by a limited number of large U.S. issuers whose industries worldwide use IFRS as the basis of financial reporting more than any other set of standards, beginning with filings in 2010. This would require amendments to various regulations, rules and forms that would permit early use of IFRS. The SEC has proposed such amendments, believing that in these circumstances the use of IFRS would enhance the comparability of financial information to investors. The SEC estimates that approximately 110 U.S. issuers would be eligible. The SEC has proposed two alternatives with respect to the disclosure of U.S. Generally Accepted Accounting Principles (GAAP) information by U.S. issuers that

SEC/CORPORATE

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qualify to elect to use IFRS financial statements in their SEC filings beginning in 2010. Under the first proposal, U.S. issuers would provide a one-time reconciliation from certain U.S. GAAP financial statements to IFRS. Under the second proposal, U.S. issuers would provide, on an annual basis, a reconciliation from IFRS financial statements to U.S. GAAP covering a three-year period. The SEC is soliciting comment on these alternative proposals to assist with assessing whether a one-time reconciliation in accordance with IFRS is sufficient or whether the ongoing disclosure of supplemental U.S. GAAP financial information by U.S. issuers that have elected to file IFRS financial statements should also be required.

The comment period on these proposals will end 90 days following publication in the Federal Register.

http://www.sec.gov/rules/proposed/2008/33-8982.pdf

Litigation

Eleventh Circuit Rules That Hedge Fund Investors' Claims Are Not Derivative

The Eleventh Circuit recently reversed in part and upheld in part a ruling by the United States District Court for the Southern District of Florida dismissing a complaint brought by investors in a hedge fund and a corporation. The plaintiffs brought claims against the persons in control of the fund and corporation for, among other things, violations of the federal securities laws. The plaintiffs alleged that the defendants made material misrepresentations that convinced them to invest. The magistrate judge, to whom the district court judge referred the case, held that the plaintiffs had alleged that the claims were common to "all investors" and therefore should have been brought as a derivative, rather than a direct claim. The district court adopted the magistrate judge's recommendation and granted the defendants' motion for judgment on the pleadings. The circuit court overruled the district court and called the magistrate judge's findings "inaccurate." The circuit court held that the complaint alleged that although "other investors" may have heard the misstatements, the plaintiffs had relied on the misrepresentations when investing their money. Therefore, the plaintiffs had alleged a direct injury. The circuit court held that "the fact that some other investors may also have been similarly injured does not transform these direct claims into derivative ones." Accordingly, the circuit court reinstated the plaintiffs' common law fraud and federal securities law claims against the defendants. By way of contrast, the circuit court affirmed the dismissal of the plaintiffs' claims that the defendants mismanaged the fund and engaged in self-dealing because those claims belong to the corporation and could only be brought derivatively. (*Medkser v. Feingold*, 2008 WL 4797512 (11th Cir. Nov. 5, 2008))

District Court Grants Officer and Director Bar

The District Court for the Eastern District of Michigan granted summary judgment in favor of the Securities and Exchange Commission. The SEC brought claims against the defendant officer of a public company for violations of the Securities Act of 1933 and the Securities and Exchange Act of 1934. Prior to the adjudication of the SEC's claims, the defendant pled guilty in both federal and state criminal courts for false statements and conspiracy. The court in the instant case found that the defendant had a full opportunity to litigate the issue in his criminal proceedings and that the litigation resulted in a final judgment that the defendant was guilty. The court also found that although the defendant never pled guilty to securities law violations, the facts were common between the causes of action to which he did plead guilty and those advanced by the SEC. Therefore, the court held that the defendant was collaterally estopped from relitigating his fraudulent conduct or his knowledge of such

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conduct. The fact that the defendant sought to withdraw his guilty plea and also filed a habeas corpus petition did not thwart the collateral estoppel effect of the plea.

Since the defendant could not relitigate the issues, the court turned to the relief that the SEC sought in connection with the defendant's fraudulent conduct. The SEC requested a permanent injunction enjoining the defendant from violating the federal securities laws again, as well as a bar preventing the defendant from serving as an officer or director of a public company. Applying a six-factor test to determine if the defendant was substantially unfit to serve as an officer or director, the court held that (i) the defendant had knowingly, deliberately and egregiously engaged in fraudulent conduct; (ii) he did not recognize the wrongful nature of his conduct; and (iii) there was a substantial likelihood that he would engage in future violations of the federal securities laws. Based on this reasoning, the court held that a permanent injunction and officer and director bar were appropriate remedies. (*SEC v. Quinlan*, 2008 WL 4852904 (E.D.Mich. Nov. 7, 2008))

Broker Dealer

NYSE Arca Proposes Options Rule Amendments Regarding Anti-Money Laundering Compliance Programs

On October 28, NYSE Arca, Inc. filed proposed rule changes with the Securities and Exchange Commission to amend NYSE Arca Options Rule 11.19, which addresses anti-money laundering compliance programs (AMLCPs). The proposed amendments clarify that each Options Trading Permit (OTP) Holder and OTP Firm (including those for which NYSE Arca is not the Designated Examining Authority) must conduct independent testing of its AMLCP on at least an annual basis and more frequently if circumstances warrant. The amendments also establish certain qualifications of the person designated to perform AMLCP testing, such as having a working knowledge of applicable Bank Secrecy Act requirements and related regulations, and provide guidelines for establishing the independence of the person performing the test.

http://www.sec.gov/rules/sro/nysearca/2008/34-58959.pdf
http://apps.nyse.com/commdata/pub19b4.nsf/docs/B3050C3D0A006BF085257505006A29BF/$FILE/NYSEArca-2008-120.pdf

SEC Approves FINRA Proposal to Amend OTC Equity Trade Reporting Rules

The Financial Industry Regulatory Authority (FINRA) received approval for a proposal to amend FINRA rules relating to trade reporting for certain "OTC Equity" transactions that are reported to a FINRA facility. The changes will apply to transactions in NMS stocks effected otherwise than on an exchange which are reported through either the Alternative Display Facility or a FINRA Trade Reporting Facility and to transactions in OTC Bulletin Board, Pink Sheet, Direct Participation Program or PORTAL equity securities which are reported through FINRA's OTC Reporting Facility. The amendments make two significant changes to the current trade reporting scheme. First, the current market-maker based trade reporting framework will be replaced with rules that generally impose trade reporting responsibilities on the "executing party" to an OTC transaction. Second, the amendments require member firms that are submitting OTC trade reports in a riskless principal or agency capacity to submit "non-tape" reports, as necessary, to ensure that all parties to a trade are identified properly. Currently, such "non-tape" reports are voluntary. These requirements would not apply to transactions that are executed on and reported through an exchange. The rule changes will become effective in approximately six months.

http://www.sec.gov/rules/sro/finra/2008/34-58903a.pdf

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SEC Staff Publishes "Core Initial Request List" for Adviser Examinations

The Securities and Exchange Commission's Office of Compliance Inspections and Examinations (OCIE) published a description of the types of information its examiners will request prior to conducting routine on-site examinations of registered investment advisers. The publication appears to be part of the SEC's efforts to bring more consistency and standardization to the examination process.

OCIE's initial information request can be organized into five broad categories:

- general information to assist in understanding the firm's business and investment activities (e.g., organizational charts, demographic data regarding advisory clients, trade blotter);
- information regarding compliance risks identified by the firm and the written policies and procedures implemented to address such risks (e.g., valuation, portfolio management, brokerage arrangements, conflicts of interest);
- documents relating to the results of and output from compliance testing performed (e.g., compliance review results, transactional testing);
- information regarding testing results and the follow-up actions taken by the firm to address weaknesses or breaches in firm policies and procedures (e.g., disciplinary actions, changes in policies/procedures, client correspondence); and
- information to perform testing of the compliance system (e.g., trade profitability, access person reports, material non-public information control and monitoring procedures).

OCIE's initial core request for information is provided for examinations of advisers that provide "traditional money management services to non-fund clients." Advisers that engage in other activities such as sponsoring registered investment companies or private funds, participating in PIPES offerings or wrap-fee programs, being registered as a broker-dealer, and operating as a manager of managers should expect information requests that include the core set of information discussed above, as well as additional information that will permit OCIE to evaluate compliance related to such additional activities.

http://sec.gov/info/cco/requestlistcore1108.htm

SEC Improves Disclosure for Mutual Fund Investors

On November 19, the Securities and Exchange Commission voted unanimously to improve mutual fund disclosure by requiring that funds provide investors with a concise, plain English prospectus summary of the key information investors need to make informed investment decisions. The rule changes are effective on February 28, 2009, and funds must begin complying with the form changes on January 1, 2010.

Specifically, the SEC adopted amendments to Form N-1A, the registration form for mutual funds, to require that every mutual fund provide a summary of key information at the front of its statutory prospectus about the fund's investment objectives and strategies, risks, and costs. The summary will include information regarding the fund's investment advisers and portfolio managers, purchase and sale procedures, tax consequences, and financial intermediary compensation.

The SEC also adopted a new rule that permits a mutual fund to send a summary prospectus in satisfaction of prospectus delivery requirements if the

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mutual fund's summary prospectus, statutory prospectus and other specified information are available online. The online materials must be user friendly, provide investors the ability to download and retain an electronic version of the information and be provided in paper or by e-mail upon request.

http://www.sec.gov/news/digest/2008/dig111908.htm

Structured Finance and Securitization

FDIC Announces Availability of IndyMac Loan Modification Model

On November 20, the Federal Deposit Insurance Corporation (FDIC) announced the release of an extensive packet of information for loan servicers and financial institutions. Known as the "Mod in a Box" guide, the packet is designed to help servicers and institutions effectuate a thorough and streamlined approach to modifying loans through the FDIC's Loan Modification Program. The program is designed to both lower mortgage payments for distressed borrowers and to increase the value of distressed mortgages by modifying them to become performing loans. Under the program, borrowers receive a loan modification with a 31% to 38% housing-to-income ratio through the use of interest rate reduction, amortization term extension, and, in some cases, principal deferment. The FDIC implemented this loan modification approach on August 20, 2008.

http://www.fdic.gov/news/news/press/2008/pr08121.html

Fannie and Freddie Suspend Foreclosure Sales

Also on November 20, Fannie Mae and Freddie Mac announced that they will suspend foreclosures and evictions between November 26, 2008, and January 9, 2009. This is to allow mortgage servicers time to work with borrowers under the streamlined modification program that was announced by the Federal Housing Finance Agency on November 11. The temporary suspension will permit affected borrowers facing foreclosure to remain in their homes while Fannie Mae and Freddie Mac work with servicers to implement the program, which is scheduled to launch on December 15. Foreclosure attorneys and loan servicers are encouraged to use the interlude to reach out to seriously delinquent borrowers and try to work out a solution less drastic than foreclosure.

http://www.fanniemae.com/newsreleases/2008/4531.jhtml;jsessionid=5ZTK0205NJHVBJ2FECISFGI?p=Media&s=News+Releases

HUD Announces Expansion of Hope for Homeowners Today

On November 19, the Housing and Urban Development Secretary Steve Preston announced that the HOPE for Homeowners Board of Directors has approved three changes to the program. The changes are designed to reduce the costs of the program and to expand eligibility, allowing more distressed borrowers to participate. The changes are:

- Increasing the loan-to-value ratio to 96.5% for borrowers whose mortgage payments represent less than 31% of their gross monthly income and who have low household debt. Borrowers with a higher debt load will continue to be offered a 90% loan-to-value ratio.

- Offering subordinate lienholders immediate payment in exchange for releasing their liens. Previously, those who released their liens had to wait for the property to be sold to receive payment, which was not guaranteed.

STRUCTURED FINANCE AND SECURITIZATION

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- Permitting lenders to extend mortgage terms from 30 to 40 years. For some borrowers, this may lower their monthly payments enough that they can afford to keep their houses.

http://www.hud.gov/news/release.cfm?content=pr08-178.cfm

CFTC

PWG to Strengthen OTC Derivatives Oversight and Infrastructure

On November 14, the President's Working Group on Financial Markets (PWG) announced several initiatives to strengthen the oversight and infrastructure of over-the-counter (OTC) derivatives markets. These initiatives include steps to facilitate the development of credit default swap (CDS) central counterparties and the establishment of a Memorandum of Understanding among the Federal Reserve Board of Governors, the Securities and Exchange Commission and the Commodity Futures Trading Commission, providing a framework for consultation and the sharing of information relating to CDS central counterparties. The PWG also announced policy objectives aimed at addressing the challenges associated with OTC derivatives and issued a progress summary of the results of ongoing efforts to strengthen the infrastructure of OTC derivatives markets.

http://www.ustreas.gov/press/releases/hp1272.htm

CFTC and SEC Prosecute Alleged Manipulation of Natural Gas Options

On November 18, the Commodity Futures Trading Commission and the Securities and Exchange Commission filed a complaint against several individuals for allegedly scheming to inflate the value of natural gas option positions held by the Bank of Montreal (BMO). According to the agencies, the defendants mismarked the values of BMO's natural gas options and engaged in a scheme to have their own bid/ask quotations adopted as independent third-party valuations as a means of circumventing BMO's internal controls.

http://www.cftc.gov/newsroom/enforcementpressreleases/2008/pr5571-08.html

Banking

Comptroller of the Currency Delivers Speech Regarding CRA and Current Economic Conditions

On November 19, Comptroller of the Currency John C. Dugan gave a speech before the Enterprise Annual Network Conference in Baltimore. In that speech, the Comptroller disagreed with suggestions that the Community Reinvestment Act (CRA) is partly responsible for the subprime crisis.

In his remarks, Mr. Dugan stated that "CRA is not the culprit behind the subprime mortgage lending abuses, or the broader credit quality issues in the marketplace." He further noted that "the lenders most prominently associated with subprime mortgage lending abuses and high rates of foreclosure are lenders not subject to CRA."

According to his remarks, during the past ten years, CRA has spurred the doubling of lending by banking institutions to small businesses and farms to more than $2.6 trillion. The speech further noted that, during the same time, such lenders more than tripled community development lending to $371 billion.

http://www.occ.treas.gov/ftp/release/2008-136.htm

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Privately Held Financial Institutions Offered TARP Capital Purchase Program Funds

In a recent Client Advisory, Katten's TARP Task Force discussed the terms of the U.S. Treasury Department's Capital Purchase Program for privately held financial institutions.

UK Developments

FSA Reiterates Concern Over Spreading Rumors

The UK Financial Services Authority (FSA) devoted most of issue 30 of its *Market Watch* newsletter (released on November 19) to emphasizing its concerns over the spreading of false or misleading rumors about listed companies.

The FSA considers that spreading false or misleading rumors about companies can be a "very damaging" form of market abuse, particularly in volatile market conditions. It has been carrying out this work in order to assess the policies and procedures firms have in place for dealing with rumors that circulate in the market.

In order to help firms address the issue, the FSA sets out in *Market Watch 30* examples of good and poor practices identified from its thematic work with respect to rumors.

http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter30.pdf

UK DEVELOPMENTS

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