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CORPORATE & FINANCIAL
WEEKLY DIGEST

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SEC/CORPORATE

SEC Issues New Compliance and Disclosure Interpretations

On June 4, the Securities and Exchange Commission's Division of Corporation Finance added new Compliance and Disclosure Interpretations (C&DIs) and revised or withdrew others.

Included in the SEC's new C&DIs is the following guidance:

- The new Item 5.07 of Form 8-K requirement to report the number of shareholder votes cast for, against or withheld applies to any matter submitted to a vote of security holders, through the solicitation of proxies or otherwise.
- Although Rule 415(a)(4) permits an issuer to register an "at-the-market" offering of equity securities without identifying an underwriter in its registration statement, the SEC has not changed its interpretation that market makers, specialists or ordinary broker-dealers that purchase registered equity securities as principal from an issuer or sell such equity securities for the issuer as an agent will ordinarily be deemed a statutory underwriter within the meaning of Section 2(a)(11) of the Securities Act of 1933 (Securities Act), even in the absence of any written agreement with the issuer.
- An issuer registering for resale shares underlying convertible debt or convertible preferred stock may include in the registration statement additional shares that may be issued pursuant to the terms of the debt or preferred stock as payment-in-kind interest or dividends.
- An issuer contemplating a registered exchange offer under Rule 13e-(4) of the Securities Exchange Act of 1934 (issuer tender offers) may communicate with its security holders prior to the first public announcement of the offering if such communication is made in accordance with Securities Act Rules 165 and 166, as applicable.
- An issuer may not use a non-automatic shelf registration statement that registers offers and sales pursuant to a dividend reinvestment plan (DRIP) more than three years after the initial effective date of the registration statement if the DRIP also permits new investors to purchase shares though the plan.
- Regulation FD does not prohibit an issuer's directors from speaking privately with shareholders or groups of shareholders, provided that the director does not disclose material non-public information to such shareholder or shareholders under circumstances in which it is reasonably foreseeable that the shareholder will trade the issuer's securities on the basis of such information; alternatively, a director may discuss such information with a shareholder or shareholders who have expressly agreed to maintain the disclosed information in confidence.
- Item 402(a)(iii) of Regulation S-K requires compensation disclosure for the issuer's three most highly compensated executive officers plus each person who served as the issuer's principal executive officer (PEO) and principal financial officer (PFO) at any time during the most recently completed fiscal year; accordingly, an executive officer who served as an issuer's PEO or PFO during such period may not be included in the determination of the issuer's three most highly compensated executive officers.

Click here to view the C&DI (Question 121A) with respect to Form 8-K.
Click here to view the C&DIs (Questions 108.01 and 108.02) with respect to Securities Exchange Act Rules.
Click here to view the C&DIs (Questions 111.01, 125.11 and 139.31) with respect to Securities Act Sections.

Click here to view the C&DIs (Questions 132.17, 164.01, 165.01, 212.21, 212.30, 212.31 and 271.16) with respect to Securities Act Rules.
Click here to view the C&DIs (Questions 115.16 and 115.17) with respect to Securities Act Forms.
Click here to view the C&DI (Question 215.04) with respect to Outdated or Superseded C&DIs.
Click here to view the C&DI (Question 101.11) with respect to Regulation FD.
Click here to view the C&DIs (Questions 117.06 and 119.27) with respect to Regulation S-K.

BROKER DEALER

SEC Approves New Stock-by-Stock Circuit Breakers Rules

On June 10, the Securities and Exchange Commission announced that it approved rules requiring the exchanges and the Financial Industry Regulatory Authority to implement new stock-by-stock circuit breakers. Under the rules, if a stock in the S&P 500® Index experiences a 10% change in price over the preceding five minutes, trading in such stock will be paused for a five-minute period. The pause is designed to allow the markets to attract new trading interest in the paused stock and provide time for buyers and sellers to trade at rational prices. The SEC anticipates that the exchanges and FINRA will begin implementing the rules as early as June 11.

The rules were first proposed jointly by the exchanges and FINRA in response to the May 6 market plunge, in which severe price volatility led to a large number of trades being executed at prices more than 60% below pre-decline prices. The rules will be in effect on a pilot basis until December 10 and will be limited to stocks in the S&P 500® Index, but SEC Chairman Mary Schapiro "hope[s] to rapidly expand the program to thousands of additional publicly traded companies." In addition to the new stock-by-stock circuit breaker rules, the SEC is working with the exchanges to consider re-calibrating market-wide circuit breakers currently in place, none of which were triggered on May 6.

To read the SEC's order addressed to the exchanges, click here.
To read the SEC's order addressed to FINRA, click here.

CFTC

CFTC Proposes Rules Requiring Equal Access to Co-Location Services

The Commodity Futures Trading Commission has published for comment proposed rules requiring a designated contract market (DCM) offering co-location or proximity hosting services to ensure that all market participants have equal access to such services. Under the proposed rules, access to co-location services must be "equitable, open and fair," and may not be offered on a discriminatory basis to select market participants or select categories of market participants. To this end, the proposed rules would also require that fees charged for co-location services be imposed in a uniform, non-discriminatory manner. "Fees shall not be used as an artificial barrier to access by any market participants." The proposed rules further provide that a DCM that offers co-location services must disclose monthly to the public on its website the longest, shortest and average latencies for each connectivity option provided by the designated contract market. This latter information would permit a market participant to assess whether incurring the benefit of co-location services is worth the cost.

Comments on the proposed rules must be submitted by July 12.

The CFTC proposal may be accessed here.

LITIGATION

Receipt of Stock Options Insufficient to Show Continuation of Alleged Conspiracy

The U.S. District Court for the District of South Carolina set aside the convictions of two employees of Medical Manager Corporation for conspiracy to commit mail, wire and securities fraud. In the indictment, the government asserted, among other things, that the defendants had conspired to manipulate the company's revenue and earnings to fraudulently inflate the market price of its stock and to use the fraudulently inflated stock to facilitate the acquisition of certain target companies. After a jury trial in which the defendants were convicted, the

defendants moved to set aside the verdict on the ground that the statute of limitations had started to run when a merger that allegedly resulted from the conspiracy was consummated.

The government argued that the statute of limitations had not run because the conspiracy continued as long as the defendants received benefits from it, pointing to the receipt of stock options by the defendants several years after the merger. The district court rejected the government's argument, holding that the court "cannot accept the de facto position that but for the conspiracy, defendants would not have received stock options." In so holding, the court pointed out that the company was successful and that employees who were not alleged to be part of the conspiracy also received options. In addition, the court held that the receipt of the options was not evidence of a continuing conspiracy because the government had not introduced any evidence that the value of the stock options had been inflated as a result of the alleged fraud. (*United States v. Kang*, Crim. No.: 9:05-CR-00928, 2010 U.S. Dist LEXIS 53003 (D.S.C. May 27, 2010))

Second Circuit Holds That Interpreting Contract as Requiring Exclusivity Would Be Illogical

The U.S. Court of Appeals for the Second Circuit has affirmed a district court ruling that held that the "plain meaning" of the contract between AT&T Corporation and KATEL Limited Liability Company with respect to the exchange of telephone calls between the United States and Kyrgyzstan did not require exclusivity.

KATEL sued AT&T for, among other things, breach of contract. The two companies had contracted so that KATEL would build and own the necessary infrastructure for the telecommunications traffic in Kyrgyzstan and AT&T would use it for a fee. Although AT&T used KATEL's service for several years, it switched to another company in Kyrgyzstan several years after the contract was signed. AT&T subsequently stopped using the other company, choosing instead to send the traffic to a third-party carrier who then took care of the routing.

The case turned on the interplay between two contractual provisions: one section in the parties' agreement required that all communications traffic from AT&T be routed directly on the AT&T-KATEL circuits, unless the direct circuits could not handle the traffic; the other section permitted each company to enter into "similar service agreements with other parties." KATEL argued that the first provision gave it the exclusive right to handle all AT&T calls to Kyrgyzstan. The district court rejected KATEL's argument and the Second Circuit affirmed, ruling that KATEL's interpretation of the first section could not be reconciled with the other terms in the agreement. As the Second Circuit explained, the contractual provision allowing the parties to enter into "similar service agreements with other parties" is inconsistent with an exclusive dealing arrangement. Thus, although the first provision appeared to give KATEL broad rights, because interpreting that provision broadly in light of the plain meaning of the second provision would lead to an "illogical result," it could not be accepted. (*KATEL Ltd. Liab. Co. v. A.T&T. Corp.*, No. 09-1575-CV, 2010 U.S. App. LEXIS 10806 (2d Cir. May 27, 2010))

BANKING

Bargain Purchase Gains Subject to Regulatory Cutback

Recent market conditions have contributed to an increase in bargain purchases, such as the acquisition of failed bank assets and liabilities. In general, a bargain purchase occurs when the fair value of the net assets acquired in a business combination exceeds the fair value of the consideration transferred by the acquiring institution. Generally accepted accounting principles (GAAP) require this excess, previously referred to as "negative goodwill," to be recognized immediately as a gain in earnings, which increases both GAAP equity and regulatory capital.

On June 7, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of Thrift Supervision (collectively, the agencies) issued guidance to address supervisory considerations related to bargain purchase gains (BPGs) and the impact such gains have on the licensing approval process, including certain supervisory and licensing conditions that may be imposed on the acquiring bank. The guidance also highlights the accounting and reporting requirements unique to business combinations resulting in bargain purchase gains and FDIC- and NCUA-assisted acquisitions of failed institutions (assisted acquisitions). The guidance does not add to or modify existing regulatory reporting requirements issued by the agencies or current accounting requirements under GAAP.

At the acquisition date, the acquiring bank will not have obtained all of the information necessary to measure the fair value of the assets acquired and the liabilities assumed in the business combination in accordance with the applicable GAAP requirements. Accordingly, GAAP allows the acquiring bank to initially record provisional fair values based on the best information available at the acquisition date. The acquiring bank should, however, retrospectively adjust these provisional amounts to reflect new information obtained during the measurement period about facts and circumstances that existed as of the acquisition date that, if known, would have affected the acquisition-date fair value measurements. Due to these potential retrospective adjustments, the acquisition-date estimated BPG and, therefore, the acquiring bank's regulatory capital, are subject to adjustment during the GAAP measurement period. As articulated in the guidance, although BPGs are included in the computation of regulatory capital for reporting purposes, a financial institution's primary regulator may determine that the acquisition-date estimated BPG lacks sufficient permanence as a component of regulatory capital for supervisory and licensing decision-making purposes. As such, certain supervisory and licensing conditions may be imposed on the acquiring bank related to, but not limited to, the following: (1) capital preservation; (2) dividend limitations; (3) independent audits, or agreed-upon procedures engagements; (4) independent valuations; and (5) legal lending limits.

Read more.

FDIC Issues Guidance on Deposit Placement and Collection Activities

On June 7, the Federal Deposit Insurance Corporation (FDIC) issued Financial Institution Letter 29-2010, *Guidance on Deposit Placement and Collection Activities by FDIC-Insured Institutions and Their Affiliates* (Guidance). In the Guidance, the FDIC addressed the issue of agreements between insured depository institutions (or such institutions' affiliates) and third-party affinity groups or trade associations (each, a group) to collect and place deposits.

The FDIC notes that the practice used by the groups, which receive referral fees for the entity's introduction to the depositor, may raise concerns under the FDIC's rules regarding "pass through" deposit insurance. According to the FDIC, "pass through" insurance means the insurance coverage (up to $250,000 currently) "passes through" the fiduciary to the actual owners of the funds if three requirements are met: (1) the institution's records expressly disclose the fiduciary relationship on behalf of others; (2) the records maintained by either the institution, the fiduciary, or an authorized third party identify the actual owner or owners of the funds in the account and their respective ownership interest in the account; and (3) the funds actually are owned by the customer(s) and not the entity performing in a fiduciary capacity.

In addition, the Guidance notes that the institutions receiving such deposits are generally accepting "brokered deposits." Although well capitalized insured institutions may receive brokered deposits without restriction, an adequately capitalized institution cannot accept brokered deposits unless the institution obtains a waiver from the FDIC. Undercapitalized institutions may not accept brokered deposits at all.

Finally, the FDIC notes that marketing materials, customer statements and disclosures must be accurate and not misleading and must correctly represent whether such funds will receive FDIC deposit insurance coverage.

For more information, click here.

INSURANCE CAPITAL MARKETS

Ambac Commutes Policies Supporting CDOs of Asset-Backed Securities with Banks

Ambac Financial Group, Inc., the parent of Ambac Assurance Corporation (AAC), announced yesterday that it had terminated all of its remaining exposure to collateralized debt obligations (CDOs) of asset-backed securities (ABS) totaling $16.4 billion. The termination or commutation involved entry by AAC into a settlement agreement with counterparties to outstanding credit default swaps with Ambac Credit Products that were guaranteed by AAC. Under the settlement agreement, in exchange for the termination of the CDO of ABS obligations, AAC paid to the counterparties a total of (1) $2.6 billion in cash, and (2) $2.0 billion in newly issued surplus notes of AAC. The surplus notes bear an interest rate of 5.1% and have a maturity date of June 7, 2020. Payments of interest and principal on the surplus notes are subject to the prior approval of the Wisconsin Commissioner of Insurance. The counterparties to the settlement and commutation agreements were Banco Bilbao of Argentina, Banco Santander, Barclays Plc, BNP Paribas, CIBC, Commerzbank, Credit Agricole, Deutsche Bank, Natixis, Rabobank Nederland, RBS, Société Generale, and UBS, as well as Citigroup.

The proposed commutation arrangements had been challenged in litigation initiated by a group of hedge funds and investment managers alleging that the holders of the CDOs were receiving preferential treatment. The Wisconsin court overseeing the rehabilitation of AAC by the state insurance commissioner rejected the challenge earlier this month.

On March 24, AAC created a segregated account and consented to rehabilitation of that account by the Wisconsin Commissioner of Insurance. Under Wisconsin law, the segregated account is accorded special treatment akin to collateral supporting a secured obligation, treated almost as a separate insurer from AAC, and was established to hold many of the financial guaranty insurance policies against which there were, or were likely to be, significant claims made against AAC, particularly policies insuring residential mortgage-backed securities and other structured finance transactions. The policies in the segregated account represent more than $35 billion in obligations. In conjunction with the creation of the segregated account, a Wisconsin state court approved the Insurance Commissioner's imposition of a temporary injunction to halt payments under policies and other contracts allocated to the segregated account, as well as actions or claims against subsidiaries of AAC whose equity interests were made part of the segregated account. The injunction was instituted to permit the Commissioner to prepare a plan of rehabilitation to protect the interests of policyholders, creditors and the public by maximizing AAC's resources available to pay claims, to provide a fair and orderly payment procedure, and to reform and revitalize AAC. A rehabilitation for a troubled insurer represents a regulatory action taken to avoid liquidation. The segregated account and order of rehabilitation were approved after AAC stated it was unable to file fourth quarter or full-year 2009 results. For the third quarter of 2009, AAC had posted losses of $573 million.

For further details on the commutation arrangements, see the Form 8-K filed by Ambac at www.sec.gov.

Rhode Island Court Rules on Stranger-Originated Annuities

A federal judge in Rhode Island last week issued a ruling that raised questions as to whether life insurers can rely on state insurable interest laws to void sales of stranger-originated annuities.

In suits brought by Western Reserve Life Assurance Co. of Ohio and Transamerica Life Insurance Co. against broker-dealers and an estate planning attorney, the carriers alleged that the defendants had paired investors with terminally ill individuals whose variable annuities provided a guaranteed death benefit. The annuitants were paid to participate in the plan under which annuities were issued in their names, but the premiums were paid for by investors. Under the terms of the annuity, if the annuitant died, his or her beneficiaries would be entitled to receive the principal originally invested, even if the underlying investments had decreased in value. Variable annuities are often sold as retirement-savings vehicles as the amounts contributed are invested in securities and the value grows over time on a tax-deferred basis. Upon retirement, an annuitant can withdraw the principal and convert it into a stream of lifetime annual payments or leave it for her heirs. In the alleged scheme, the investors purportedly used a longer-term investment product for short-term gain.

In the arrangement challenged in Rhode Island, the carriers claimed the annuities should be declared void because the beneficiaries, who were unrelated to the annuitants, had no insurable interest in their continued lives. The judge distinguished the annuities from life insurance policies, holding that no insurable interest was required for these annuities and that the marketing materials for the product presented the death benefit as "an ancillary perk," not as a central feature. While dismissing the carriers' claims for rescission, the judge let stand certain fraud, conspiracy and other claims against the defendants. The decision represents a setback for life insurance companies, but its ultimate precedential impact is unclear. (*Western Reserve Life Assurance Co. of Ohio v. Conreal LLC, et al.* (U.S.D.C., District of Rhode Island, C.A. No. 09-470 S.))

EXECUTIVE COMPENSATION AND ERISA

IRS Finalizes Public Employer Stock Fund Diversification Requirements

On May 19, the Internal Revenue Service issued final regulations that clarify when public companies must allow plan participants to voluntarily divest employer stock allocated to their retirement plan accounts. The regulations only apply to public companies that maintain defined contributions plans (typically referred to as 401(k) plans or profit-sharing plans) where employer stock is an available investment alternative. The regulations require that, subject to certain limited exceptions, participants must always be able to move their own contributions (including rollover contributions) out of employer stock funds. In addition, employer contributions must be eligible for movement from the employer stock fund once the participant has provided three years of service to the company.

The regulations finalize rules first enacted by Congress in 2006. The Pension Protection Act of 2006 required greater diversification rights for public employer stock funds in order to address situations where a company's stock was falling but retirement plan participants were powerless to diversify their accounts and minimize their losses. While the increased flexibility helps participants who will no longer be locked in to one, undiversified investment, the new rules can also help plan fiduciaries avoid liability for maintaining the stock fund in times when the value is declining.

In order to comply with the final regulations, retirement plans must have at least three other diverse investment alternatives available under the plan (although, plans typically have many more alternatives). In addition, the plan cannot impose any direct or indirect conditions on investment in, or divestment of, employer stock that do not apply to other plan investment alternatives. For example, with limited exception, the final regulations would not permit a restriction that permanently prohibits amounts from being reinvested in employer stock if it was previously divested from employer stock.

While interim diversification guidance is currently in effect, the final regulations become effective for plan years beginning on and after January 1, 2011.

The final regulations can be found here.

UK DEVELOPMENTS

FSA Annual Report Published

On June 10, the UK Financial Services Authority (FSA) issued its annual report covering the year ended March 31, 2010. The FSA emphasized its priorities and targets including:

- a radically changed approach to prudential supervision, particularly of high impact firms, including stress testing, accounting reviews, challenges to business models, detailed liquidity assessments and reviews of remuneration policy;
- a fundamental change in its enforcement approach, aiming for "credible deterrence" and pursuing market abuse and management responsibility far more aggressively;
- the launch of a new approach to "conduct" risk, improving customer protection in retail markets by earlier intervention to reduce the scale and frequency of problems potentially leading to customer detriment; and
- the need for increased involvement in international and European regulatory initiatives.

Among many specific issues addressed in the 127-page report was market confidence. While highlighting action taken and planned against insider dealing and market abuse, the market confidence section of the report highlighted the result of FSA's latest Market Cleanliness Study, which showed a further increase (from 29.3% to 30.6%) in the number of takeovers preceded by abnormal pre-announcement price movements.

Read more.

FSA Continues to Focus on Client Money

The UK Financial Services Authority (FSA) has recently written to the chief executive officers of all firms handling client money and assets seeking a response before June 30:

- confirming that their controls over the handling of client money and assets have been reviewed by management;
- stating whether or not the firm is in compliance with its obligations respecting client money and assets; and
- identifying the person at the firm with overall responsibility for compliance with FSA's client money and assets rules.

The letter follows up an FSA communication earlier this year that pointed out significant weaknesses and failings discovered during visits to firms carried out in late 2009. It also comes at the same time as several highly publicized disciplinary actions and fines imposed by the FSA on regulated firms for client money failings.

In addition, the FSA focused on this area in its Annual Report (see "FSA Annual Report Published," above), in which it stated its concern that firms "were not always achieving an adequate level of client money protection,

thereby potentially threatening market confidence in the UK financial services industry." The FSA added that it had taken and would continue to take "various actions to address risk in this area. We have increased dedicated visits to firms, and have expanded, and continue to expand, the level of resource within the FSA dedicated to client money and assets supervision."

Read more.

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