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Corporate and Financial Weekly Digest

APRIL 30, 2010

## SEC/CORPORATE

**SEC Announces Filing Fee Increases for FY 2011**

On April 29, the Securities and Exchange Commission announced that for the government's fiscal year 2011, registration fees under the Securities Act of 1933 will increase from the current rate of $71.30 per $1 million registered to $116.10 per $1 million, an increase of approximately 63%. This increased rate will also be applicable to the repurchase of securities in going-private transactions pursuant to Section 13(e) of the Securities Exchange Act of 1934, as well as to proxy solicitations and statements in corporate control transactions. The fee rate applicable to securities transactions on the exchanges and in certain over-the-counter markets will at the same time increase from $16.90 per $1 million to $19.20 per $1 million.

The SEC calculated the new rates under the Investor and Capital Markets Fee Relief Act, which sets dollar targets for statutory fee collections for each fiscal year. The SEC must set fee rates to levels that it projects will generate collections equal to such targets. For the 2011 fiscal year, the dollar targets increase under the Act.

The new filing fee rate will be effective on October 1, 2010, or five days after the date on which the SEC receives its regular appropriation from Congress, whichever is later, with the new fee rate applicable to securities transactions on the exchanges and over-the-counter markets becoming effective 30 days after the date on which the SEC receives its congressional appropriation. The SEC will publicly announce the actual effective dates of the new fees. In the past, congressional delays in passing appropriations bills have resulted in effective dates well beyond October 1.

Click here for the SEC's order regarding the 2011 fee increases.
Click here for the SEC's related filing fee advisory.

## BROKER DEALER

**SEC Approves Reporting of Asset-Backed Securities Transactions to TRACE**

Beginning February 14, 2011, firms must report asset- and mortgage-backed securities transactions to the Trade Reporting and Compliance Engine (TRACE). Although the Financial Industry Regulatory Authority will not disseminate the data it collects, it will study the transaction data and may propose to disseminate it in the future. Reporting fees for asset- and mortgage-backed securities transactions and other related amendments to TRACE and FINRA rules also will go into effect at that time.

Click here to read FINRA Regulatory Notice 10-23.
Click here for information on FINRA's original proposal to require TRACE reporting for asset-backed securities in the October 9, 2009, edition of *Corporate and Financial Weekly Digest*.

**SEC Approves Amendments to Require Reporting of OTC Trades in Equity Securities Within 30 Seconds of Execution**

Effective November 1, the Financial Industry Regulatory Authority will require firms to report over-the-counter transactions in equity securities to FINRA within 30 seconds of execution for transactions that are executed during the hours that FINRA trade facilities are open. The new reporting time frame also applies to stop stock and prior reference price trades, as well as trade cancellations that are currently subject to 90-second reporting. Firms will also be required to report secondary market transactions in non-exchange-listed direct participation program securities within 30 seconds of execution. FINRA reminds firms that they must report trades as soon as practicable and must not withhold trade reports, such as by programming their systems to delay reporting until the last permissible second. Firms that rely on manual trade reporting processes may qualify for an additional six months for implementation, as further described in the FINRA Regulatory Notice.

Click here to read FINRA Regulatory Notice 10-24.

## PRIVATE INVESTMENT FUNDS

**ABA Letter Argues Dodd Bill Would Limit Rule 506 Offerings**

In an April 23 letter to Senators Christopher Dodd (D-Conn.) and Richard Shelby (R-Ala.), Nathaniel Doliner, Chairman of the American Bar Association's Business Law Section, expressed concern that Section 926 of the recently proposed Restoring American Financial Stability Act of 2010 (the Dodd Bill) would effectively eliminate the federal preemption of state securities law enacted by Congress under the National Securities Markets Improvement Act of 1996 (NSMIA) in connection with private offerings by smaller companies. Section 18 of the Securities Act of 1933 exempts from state registration "covered securities" which are defined, among other things, as securities exempt from federal registration under rules or regulations promulgated by the Securities and Exchange Commission under Section 4(2) of the Securities Act, including Rule 506 under Regulation D. Interests in most private investment funds offered in the United States are exempt from federal registration under Rule 506 of Regulation D. Section 926 of the Dodd Bill directs the SEC to designate some securities as non-covered securities because the offering of such securities is not of sufficient size or scope. Section 926 also requires the SEC within 120 days to review any filings made with the SEC relating to any covered security or make a determination that there has been a good faith attempt by the issuer to comply with the filing requirements or the security would no longer be a covered security. Chairman Doliner argues that Section 926 would add cost, delay and confusion to the private offering process without necessarily providing any countervailing investor protection benefits, and would largely restore private offerings to their status prior to the adoption of NSMIA.

To read the text of the Doliner letter, click here.
To read the text of the Dodd Bill, click here.

## CFTC

**Futures Industry Association Releases Market Access Risk Management Recommendations**

The Futures Industry Association Market Access Working Group, consisting of representatives from derivatives exchanges, clearing firms and trading firms, has published risk management recommendations for futures and options exchanges offering direct access trading. The recommendations are intended to establish industry best practices for exchanges offering direct access by identifying risk-specific controls that are already in place at some exchanges, clearing firms and direct access trading firms and by recommending controls that should be in place before direct access trading is permitted.

The recommendations cover a number of topics including pre-trade order checks, post-trade checks, conformance testing and error trade policies, and are divided into guiding principles and specific implementation recommendations. There is an additional section on collocation policies, which, while not specifically related to risk management, is a topic of interest to exchanges offering direct access and to clearing firms and direct access trading firms.

The recommendations can be found here.

**CFTC Determines Seven Contracts Traded on ICE Are Significant Price Discovery Contracts**

The Commodity Futures Trading Commission has determined that seven contracts traded on IntercontinentalExchange Inc. (ICE) perform significant price discovery functions and, therefore, must be traded in compliance with the statutory provisions, including core principles, applicable to "significant price discovery contracts" (SPDCs). The CFTC has determined that the following ICE products are SPDCs: ICE HSC Financial Basis Contract, ICE Waha Financial Basis Contract, ICE AECO Financial Basis Contract, ICE NWP Rockies Financial Basis Contract, ICE Socal Border Financial Basis Contract, ICE PG&E Financial Basis Contract and ICE Chicago Financial Basis Contract.

The CFTC press release can be found here.

# LITIGATION

### Sixth Circuit Rules That Officer/Director Bar Is Not Punitive

The Sixth Circuit Court of Appeals affirmed a district court's award of a permanent injunction and a director/officer bar in a Securities and Exchange Commission enforcement action against Patrick Quinlan, the former CEO and Chairman of the Board for MCA Financial Corporation, pursuant to which Mr. Quinlan was enjoined from future violations of the securities laws and prohibited from acting as an officer or director of any publicly traded company.

In its complaint, the SEC alleged that Mr. Quinlan, and others, committed numerous violations of securities laws and regulations by, among other things, participating in a fraudulent scheme between 1994 and January 1999 to falsely inflate income and hide losses at MCA Financial, with the scheme resulting in more than $256 million in total losses.

The SEC's enforcement action originally was stayed pending the resolution of related criminal prosecutions. In the criminal proceedings, Mr. Quinlan pleaded guilty to both federal and state charges and was sentenced to 120 months in prison in the federal case and a concurrent one-year term in the state prosecution. He was ordered to pay $256 million in restitution by the federal court and $83 million by the state.

The stay in the SEC enforcement action was then lifted and Mr. Quinlan litigated the case *pro se*. On the merits, the SEC moved for and obtained summary judgment under the doctrine of collateral estoppel, relying on Mr. Quinlan's criminal guilty plea. With regard to remedies, Mr. Quinlan moved to dismiss the SEC's claim for civil money penalties, permanent injunctive relief and an officer/director bar arguing, among other things, that such remedies were precluded by the five-year statute of limitations set forth in 28 U.S.C. Section 2462, which governs any suit or proceeding for the enforcement of any civil fine, penalty or forfeiture, pecuniary or otherwise.

In response, the SEC voluntarily dismissed its claim for civil money penalties (conceding that civil money penalties were subject to the five-year limit in 28 U.S.C Section 2462), but argued that the permanent injunction and officer/director bar were remedial in nature, not punitive, and therefore were not subject to the limitations period at all.

The Sixth Circuit observed that some courts hold that equitable remedies such as a permanent injunction and an officer/director bar are exempt from the statute of limitations as a matter of law, while others have engaged in an individualized inquiry to determine whether such remedies may be "punitive" based on the facts of a particular case. While not deciding which approach was required, the Sixth Circuit affirmed the district court's individualized analysis and concluded that the injunction and the officer/director bar were remedial rather than punitive because Mr. Quinlan posed a substantial risk of recurrence, and the risk to the investing public outweighed the collateral consequences of the equitable relief sought by the SEC. (*SEC v. Quinlan,* No. 08-2619, 2010 WL 1565473 (6th Cir. Apr. 21, 2010))

### Court Refuses to Take Judicial Notice of Securities Violations in Related Action

Donald Reneker, a court-appointed special receiver for AmeriFirst Funding, Inc., and several related entities, brought a malpractice action against AmeriFirst's former outside counsel alleging that the firm acted improperly in advising AmeriFirst regarding the issuance of certain collateralized debt securities and in responding to a related state regulatory inquiry. Mr. Reneker's first two complaints were dismissed by the U.S. District Court for the Northern District of Texas for failure to adequately allege that the firm breached a duty owed to AmeriFirst itself (rather than a duty owed to others, e.g., investors or securities authorities).

Mr. Reneker then filed a third complaint alleging that AmeriFirst's outside counsel acted negligently in responding to the Texas State Securities Board's inquiry requesting information about the offering of AmeriFirst debt securities, and by failing to ensure that AmeriFirst's offerings were in compliance with all relevant securities laws and regulations.

The defendants again moved to dismiss on the grounds that Mr. Reneker's third complaint failed to state a claim on which relief could be granted and that the complaint was barred under the doctrine of *in pari delicto*. In support of its motion to dismiss, the law firm argued that the court previously determined in a related SEC enforcement action that AmeriFirst had knowingly violated the securities laws in connection with the sale of the debt securities at issue. The law firm asserted that the court should take judicial notice of its findings in the SEC enforcement action, and that the prior findings directly contradicted the factual allegations in Mr. Reneker's third complaint.

The court determined that (a) Mr. Reneker's third complaint supplied sufficient additional details to cure the defects in his prior pleadings and (b) judicial notice of the court's findings in the SEC enforcement action was not warranted notwithstanding the fact that the same court and the same judge were handling both cases.

In reaching this conclusion, the court determined that the SEC enforcement action was complex and that taking judicial notice of facts found in that case would be unfair to AmeriFirst and the other parties represented by Mr. Reneker. The court further relied on the fact that the SEC enforcement action and the Reneker case did not involve "precisely the same parties and issues."

Although the court refused to take judicial notice at the pleading stage, it observed that the law firm could use the findings in the SEC action to impeach Mr. Reneker's claims on summary judgment and/or at trial. (*Reneker v. Offill,* 3:08-CV-1394-D, 2010 WL 1541350 (N.D. Tex. Apr. 19, 2010))

## BANKING

**FDIC Proposes Change to Deposit Insurance Assessment System**

On April 13, the Federal Deposit Insurance Corporation (FDIC) issued a proposal that would change the calculation of deposit insurance assessments for "large" or "highly complex" institutions. The proposal defines "large institutions" as those with $10 billion or more in total assets for four consecutive quarters (other than insured branches of foreign banks). A "highly complex" institution is defined in the proposal as (i) an insured depository institution with greater than $50 billion in total assets that is wholly owned either by a parent company with more than $500 billion in total assets or by one or more intermediate parent companies that are wholly owned by a holding company with more than $500 billion in assets, or (ii) a processing bank and trust company with more than $10 billion in total assets. According to the FDIC press release, large and highly complex institutions "pose unique and concentrated risks to the Deposit Insurance Fund."

The FDIC enumerated three goals with respect to the proposal: (1) to better capture risk at the time the institution assumes the risk; (2) to better differentiate among institutions during periods of good economic and banking conditions based on how they would fare during periods of stress or economic downturns; and (3) to better take into account the losses that the insurance fund could incur if an institution failed.

Pursuant to the proposal, the FDIC would replace CAMELS ratings and certain financial measures currently used with a "scorecard" consisting of well-defined financial measures that are more forward looking. Two different scorecards would be created: one for large institutions and another for highly complex institutions. Each scorecard would consist of a performance component, which would measure an institution's financial performance and its ability to withstand stress, and a loss severity component, which would correspond to the level of potential losses in case of failure. The proposal permits the FDIC to adjust each component where necessary to produce accurate relative risk rankings.

In addition to changes to the deposit insurance system for large or highly complex institutions, the proposal also alters assessment rates applicable to all insured depository institutions to ensure that revenue under the new system would approximately equal that under the existing assessment system and also to ensure that the lowest rate applicable to both small and large institutions would be the same.

The proposal also includes questions about how to incorporate other risk measures in the future (i.e., quality of underwriting or risk management practice). The proposal is open for a 60-day comment period; the proposed effective date for such changes, however, is January 1, 2011. Notably, the proposal states that the FDIC anticipates that a further round of rulemaking may be needed to improve the large bank assessment system.

Read more.

## EXECUTIVE COMPENSATION AND ERISA

**Investment Adviser Convicted of Defrauding Employee Benefit Plan**

On April 16, the U.S. Attorney for the Eastern District of Michigan, together with the Regional Director for the Employee Benefits Security Administration (EBSA) and the Federal Bureau of Investigation's Special Agent in Charge, announced the conviction of Anthony James for 14 criminal counts relating to his operation of a Ponzi scheme. The charges included mail fraud, wire fraud and embezzlement from an employee benefit plan. Mr. James, an investment adviser from Parkland, Florida, was indicted on charges that he received over $5.3 million from more than 40 investors, including pension plan participants.

Instead of investing the money, Mr. James spent approximately $2.5 million on personal items including two residences and several cars while using the remaining amount (approximately $2.8 million) to pay back earlier investors. In the press conference following the conviction, Paul Baumann, Director of the EBSA's Cincinnati Regional Office, declared, "This criminal action demonstrates the Labor Department's resolve to vigorously enforce the law to ensure that those who steal from contributory employee benefit plans are brought to justice." Theft or embezzlement from an employee benefit plan carries a $250,000 fine and a maximum penalty of five years imprisonment. James is scheduled to be sentenced on August 17.

The Department of Labor press release regarding the conviction can be found here.

## UK DEVELOPMENTS

**FSA Fines Commerzbank for Transaction Reporting Failures**

On April 27, the UK Financial Services Authority (FSA) announced that it had fined the London branch of Commerzbank AG £595,000 (approximately $920,000) for failing to provide transaction reports promptly and correctly to the FSA. This is the fifth substantial fine imposed by the FSA for transaction reporting breaches since August 2009 and follows the three fines reported in the April 9 edition of *Corporate and Financial Weekly Digest*.

Under FSA rules, firms are required to submit accurate data for reportable transactions by close of business the day after a trade is executed.

The FSA found that Commerzbank had either failed to report or reported inaccurately almost all of its reportable transactions for a two-year period. This occurred despite the FSA sending repeated reminders to firms of their obligations to provide accurate data and the importance of compliance with transaction reporting rules, as well as sending specific requests to Commerzbank for the firm to check its data.

Commerzbank has since taken a number of steps to address the concerns raised, including commissioning a review of its transaction reporting process and committing extensive resources to improve its processes and resolve the errors.

The FSA's Director of Markets said, "Complete and accurate transaction reports are an essential component of the FSA's market monitoring work. Commerzbank's reporting failures could have a damaging impact on our ability to detect and investigate suspected market abuse. Firms and their management must ensure they submit quality transaction reporting data."

To read more, click here.


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