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Both Sides Appeal Ontario Insider Trading Dispute

Ontario's regulator and the lawyer for an individual it charged with insider trading have appealed his sentence.

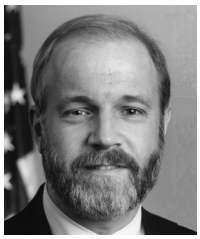
See story, page 2

COMMISSION CONSIDERS REGISTERING AUDITORS OF NON-PUBLIC B/Ds

A concept release that would gather ideas on whether the **Securities and Exchange Commission** should subject auditors of non-public broker/dealers to accounting regulations is in the works. The SEC plans to consider proposing these auditors register with the **Public Company Accounting Oversight Board**, which would expose them to layers of accounting standards and rules mandated by the Sarbanes-Oxley Act for auditors of public companies. While such a requirement would not affect the largest firms since they are publicly-traded,

(continued on page 12)

SEC RESTRICTS HEDGE FUND USE OF LOCKUP PERIOD



Robert Plaze

The **Securities and Exchange Commission** has imposed restrictions on the ability of hedge fund advisers to rely on a loophole to skirt registration as investment advisers. The loophole allows hedge fund managers to impose a two-year lockup on investments in their fund and avoid the requirement to register with the SEC by February of next year.

A no-action letter released last Thursday indicates that if a fund's

(continued on page 11)

BONUSES UP FOR B/D, HEDGE FUND COMPLIANCE OFFICERS

Bonuses will be up roughly 5-10% over 2004 for compliance officers at U.S. broker/dealers, hedge funds and investment advisers, say recruiters. They attribute the increases to the higher profits on Wall Street in 2005 and overall demand for experienced compliance staff. **Michael Lord**, principal of the New York-based **Michael Lord & Co.**, said the increase would give

(continued on page 11)

Survey Says…

PENSION CONSULTANTS ENHANCING CONFLICT DISCLOSURES

Lori Richards

Investment advisers providing pension consulting services are drafting enhanced procedures for preventing and disclosing potential conflicts of interest, a survey conducted by the **Securities and Exchange Commission** has found. As of Oct. 31, more than 1,800 SEC-registered investment advisers, or almost 20% of all registered advisers, indicated they provide pension consulting services, **Lori Richards**, director of the SEC's Office of

(continued on page 11)

Dispute Over RBC Director Appealed On Both Sides

Both the **Ontario Securities Commission** enforcement staff and an individual they accused of insider trading have appealed the sentence imposed on him. **Andrew Rankin**, a former managing director in the Mergers and Acquisitions Department of **RBC Dominion Securities**, was sentenced to six months in jail on each of 10 counts of insider tipping. He was charged with telling a colleague about a potential merger. The sentence is to be served concurrently. But the OSC is saying the sentence is too short and Rankin's lawyer, **Brian Greenspan**, partner at **Greenspan, Humphrey, Levine, Barristers** in Toronto, says the judge did not justify his conclusions that there were violations. His appeal states the judge erred interpreting "voluntariness" as it applies to offense of insider tipping. The appeal claims the judge discounted the timing of the alleged tips and whether Rankin had material information at the time of the alleged tip—as opposed to the time of the trade.

The OSC's notice of appeal, however, states, "The trial judge imposed a demonstrably unfit sentence of six months where the maximum sentence was two years on each of the 10 counts, in light of the repeated insider tipping by the defendant." The notice states the sentence is not enough of a deterrent. OSC spokesman **Eric Pelletier** declined to comment beyond it.

Walter Still Tops List For SEC's IM Chief

With only a few weeks left before the **Securities and Exchange Commission** interim director of the Division of Investment Management departs, one name still dominates speculation about who will get the job—**Elisse Walter**, e.v.p. of regulatory policy and programs at the **NASD**. People who have talked to her about this position say in private she is equivocal when asked if she wants the post. Walters, through an NASD spokesman, declined to comment last week.

A spokesman for the SEC declined to comment either on what steps the Commission was taking to find a director or what will happen when the current acting director, **Meyer Eisenberg**, leaves in January.

The **Investment Company Institute** was said by industry insiders to be taking a vigorous interest in monitoring what happens next in this pivotal moment in the industry's relations with its regulator. ICI is supposed to have alerted some of in the industry that within the past 10 days SEC has suddenly begun actively searching hard to replace Eisenberg and the last permanent head of the division, **Paul Roye**, who left in March. About that time the SEC learned that Eisenberg was leaving so he could be ready to take a teaching post in time for the spring quarter. Coincidentally, Walter will be a keynote speaker tomorrow at ICI's annual Securities Law Development Conference. An ICI spokesman would only say the trade group is monitoring what the SEC is doing to replace Roye.

One other lawyer's name cropped up in last week's buzz about who will get the job, **Matthew Chambers**, partner at **Wilmer Cutler Pickering Hale & Dorr**. But he seemed to be a less likely candidate. A call to Chambers was not returned. Some said Walter would be a bridge between Investment Management and [the Division of] Market Regulation. The two divisions have long had turf wars. Since NASD regulates the brokerage industry, Walter would be able to balance the perspectives of both divisions if she were tapped for the IM position.

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Institutional Investor NEWS
INTELLIGENCE FIRST

Brokerage

Former Merrill Compliance Head Returns To Morgan Lewis

Anne Flannery, one-time global head of compliance for **Merrill Lynch**, has rejoined **Morgan Lewis & Bockius** as a partner in the law firm's securities practice in New York. Flannery said her focus will be on representing financial institutions and individuals in **Securities and Exchange Commission** investigations and **New York Stock Exchange** and **NASD** enforcement matters. Flannery originally joined Morgan Lewis in 1987 and served as a partner from 1989 to 1999 when she joined Merrill Lynch.

Flannery served in numerous senior-level positions at Merrill, most recently as first v.p. and general counsel for global regulatory affairs. "I'm looking forward to working for a number of clients," Flannery said. "I enjoyed private practice in the past." Flannery, who left Merrill Lynch in May, was replaced by **David Kornblau**, who had served as chief litigation counsel at the SEC.

SIA Seeks More Specifics In OATS Proposal

The **Securities Industry Association** has asked the NASD to specify what securities and markets meet the definition of an over-the-counter (OTC) equity security for Order Audit Trail System (OATS) purposes. The NASD recently proposed amendments to Rules 6951 and 6952 to require members to file OATS info relating to OTC equity securities. In a comment letter to the **Securities and Exchange Commission**, the SIA Self-Regulation and Supervisory Practices Committee said its members are confused about how the rule should be interpreted in light of the multiple definitions for "OTC security." Members are also unsure what "OTC" will mean once the SEC's Regulation NMS is fully implemented. The letter states that the SIA could support the expanded requirement if the NASD clearly defines the types of securities and justifies its reason for including them.

The SIA noted that firms are already undergoing significant changes to meet the requirements of OATS Phase III and Reg NMS. The letter states that the changes will become more complex as types of securities are added. "The Committee is concerned that requiring OATS reporting for a manually-intensive trading market such as the OTC equity market in the midst of these major initiatives could be the equivalent of mandating decimal conversion in the months leading up to Y2K," the letter states. Calls to SIA spokesman **Travis Larson** were not returned. NASD spokesman **Herb Perone** said the NASD does not comment on comment letters.

SEC Might Rely On ASB Statement For B/D Audit Exams

The **Securities and Exchange Commission** might rely on factors from an **Auditing Standards Board** release when it examines broker/dealer auditing programs. The SEC is in the process of expanding its B/D risk assessment to include internal audit records (CR, 10/31). In a speech in New York on Nov. 30, **Mary Ann Gadziala**, associate director of the SEC's Office of Compliance Inspections and Examinations, gave some insight into what the SEC will be looking for in the exams. She said that the ASB's Statement on Auditing Standards 65 (SAS 65) provides guidance for external auditors looking at internal audits to determine what procedures to perform. "While the focus of SAS 65 is auditing financial statements, the basic principles appear to be relevant to our more broad-based audits of risk management examinations conducted over the past decade," Gadziala said in the speech.

The ASB statement, entitled "The Auditor's Consideration of

Brokerage (cont'd)

the Internal Audit Function in an Audit of Financial Statements," outlines key factors to assess the competence and objectivity of the internal auditors, she said. "These are very similar to factors we may consider in examining the competence and objectivity of internal audit at a B/D," she said. The factors include: education and experience; professional certification and continuing education; audit policies, programs and procedures; practices regarding assignments; supervision and review of auditors' activities; quality of work paper documentation; reports and recommendations; and evaluation of internal auditors' performances.

Gadziala also noted that SAS 65 outlines factors to evaluate auditors' work. The factors include: whether the scope of the work is appropriate to meet the objectives; whether the audit programs are adequate; the quality of documentation of work papers; that conclusions are appropriate; and that the reports are consistent. "Our examinations may also consider the tracking, follow-up, reporting to top management, remediation, and resulting improvements to the audit process," she said. One compliance officer at a large B/D in New York said the exams could potentially have a chilling effect on firms that have strong audit programs. He said it is probably too early to tell whether or not examiners will follow the SAS 65 model.

Lawyers Weigh Pros, Cons Of NYSE Arb Rule

Steven Caruso

Lawyers cited both a positive impact and possible drawbacks of a newly approved **New York Stock Exchange** arbitration rule. Rule 607, approved by the **Securities and Exchange Commission** in late November, allows customers the option of choosing arbitrators from a random list instead of having them appointed by the NYSE. Under the new system, the NYSE will randomly select 15 arbitrators, which both parties will have the option to strike. The change brings the NYSE inline with the **NASD**, which has used the system for a few years, lawyers said. **Steven Caruso**, a partner at **Maddox Hargett & Caruso** and president-elect of the **Public Investors Arbitration Bar Association**, said the change could improve arbitrator selection because the NYSE has a habit of appointing the same arbitrators again and again. He said it will give both customers and firms a greater control over the selection process.

Romaine Gardner, a law professor at **Fordham University School of Law** in New York and head of the school's arbitration clinic, said the problem with the random selection process is that sometimes parties get stuck with unqualified arbitrators. He described one instance where he ended up with a panel chair who had never even decided a case. Gardner noted that the rule seems like an attempt to improve the process for customers without giving too many concessions to member firms. **Constantine Katsoris**, chairman of the **Securities Industry Conference on Arbitration**, noted that both the NYSE and NASD did not adopt SICA's proposal for arbitrator selection. Under SICA's rules, if the two parties cannot agree on anybody from the list of arbitrators, a second list is sent out. "In saving time, they're giving the parties less of an option," he said. **Karen Kupersmith**, director of NYSE arbitration, said the rule was designed to create more transparency and a more level playing field in arbitrator selection.

NYSE Should Rework Proposed Outsourcing Rules, SIA Says

The **Securities Industry Association** has asked the **New York Stock Exchange** to revamp its proposed outsourcing rules. The NYSE's proposed Rule 340 and proposed amendments to Rule 342.30(c) would require members to have appropriate procedures for outsourcing. "Given the need for flexibility, we believe that prescriptive rules with detailed requirements are not an effective method of regulating outsourcing," the Outsourcing Subcommittee of the SIA's Technology & Regulation Committee told the NYSE in a comment letter. The SIA said outsourcing principles should be the same as those guiding a member firm's supervision responsibilities.

The SIA asked NYSE to coordinate its outsourcing rulemaking with other regulators to avoid duplication. It highlighted a recent NASD Notice to Members, which emphasized that each member firm's supervision should be tailored to its business structure. The SIA also said the NYSE rules should be consistent with existing guidance put out by the **Basel Committee on Banking Supervision** and the **International Organization of Securities Commissions** (CR, 8/9/04). It also wants the NYSE to exempt firms who have been approved by the **Securities and Exchange Commission** for consolidated supervision. The SIA said the proposal would create contradictory regulatory burdens on those firms. To date, five large U.S. broker/dealers have been approved for consolidated supervised status (CR, 12/5).

The SIA is concerned about a passage in one of the rules that requires members to rework their outsourcing agreements to include provisions allowing the NYSE to terminate or suspend the agreement. "We are not aware of a parallel in any other area of securities regulation where the Exchange can compel a member firm to terminate a relationship," the letter states. Instead the SIA would like the rule to give NYSE the right to

review relevant records. Then, if the NYSE finds a deficiency the firm would have to correct the problem or terminate the agreement. Calls to SIA spokesman **Travis Larson** were not returned. NYSE spokesman **Brendan Intindola** had no comment.

Corporate Finance

Atkins Says SEC Staff Should Not Base Enforcement On Guidance

Paul Atkins

Commissioner **Paul Atkins** of the **Securities and Exchange Commission** said the staff should not be relying on informal guidance as the basis for accounting enforcement actions. During a speech at an **American Institute of Certified Public Accountants** conference in Washington, D.C., on Monday, Atkins said in one SEC enforcement case this year, the registrant was faulted for failing to change its accounting methods based on a list of frequently-asked questions from SEC staff.

The Commission was also told that the registrant's procedures disregarded a statement made by the SEC staff at an AICPA meeting. The procedures preferred by SEC accountants should not be viewed as binding, he said. If the SEC believes that everyone should follow a particular approach, the approach should be set forth in a rule or standard that has been subjected to a comment period, he said, according to the prepared text of his speech. "This is not just my personal view; it happens to be the law of the land."

Investment Management

Enforcement Action Highlights Performance Fee Calculations

An enforcement action against an investment adviser underlines the importance of providing consistent disclosure of performance-based fee calculations in the advisory contract and regulatory filings. The **Securities and Exchange Commission** alleged Dallas-based **RENN Capital Group** charged excessive performance fees. **Timothy McCole**, branch chief of the SEC's Fort Worth District Office that filed the action, said the disclosure staff of the SEC's Division of Investment Management discovered the discrepancy regarding the fee calculation in RENN Capital's filings and advisory contract.

The SEC alleged that RENN Capital overcharged the Renaissance Capital Growth & Income Fund III from Jan. 1, 1996 to Dec. 31, 2003. RENN Capital included unrealized capital appreciation in the formula used to calculate the fees and in doing so, violated the statutory formula in the Investment Advisers Act, the order stated. RENN Capital did not disclose in its Form 10-Q and Form 10-K reports filed to the SEC that it had included unrealized capital appreciation in the formula for fee calculation. The adviser, however, amended the Renaissance fund's advisory contract in 1998 with a description of how the performance fee was actually calculated and in 2000 and 2001, included the advisory contract as an exhibit to its 10-K.

The adviser should have disclosed the use of unrealized capital appreciation in the calculation of fees in the narrative portion of the Form 10-K, McCole said. Initial disclosure of the fee calculation method in the Forms 10-K would have alerted the SEC that RENN Capital was not using the statutory formula, he added.

The SEC order imposed penalties for excessive performance fees, omitting material information in filings and failing to provide a preliminary proxy statement prior to amending the fund's advisory contract. RENN Capital consented to a settlement with the SEC without admitting or denying the order's findings. The firm was ordered to pay the Renaissance fund $2,851,362 in disgorgement plus $924,509 in prejudgment interest. In addition, RENN Capital will pay a civil penalty of $100,000 to the fund. **Steven Boehm**, partner at **Sutherland Asbill & Brennan** in Washington, D.C., and counsel to RENN Capital, did not return calls by press time.

ICI Warns Fund Volatility Ratings Do Not Help Investors

The **Investment Company Institute** has reiterated its long-standing opposition to the inclusion of bond mutual fund volatility ratings in fund sales literature. The **Securities and Exchange Commission** solicited comment on a proposal to permanently approve **NASD** Rule 2210(c)(3) and Interpretive Material 2210-5 concerning bond mutual fund volatility ratings prior to the expiration of a pilot program on Dec. 29. The ICI recommended the **NASD** prohibit use of the ratings altogether in a letter to SEC dated Nov. 28. The ICI is concerned investors will focus on a rating and not on the broader issues related to the fund, said **Ari Burstein**, associate counsel of the ICI in Washington, D.C. Comments on the rule proposal were due Nov. 28. The ICI has previously raised concerns about the use of volatility ratings in sales literature in letters written in 2003, 2001, 1998 and 1997.

The ICI letter suggested safeguards to be implemented for investor protection in the event the SEC decides to approve the proposed rule. The Institute recommended the SEC prohibit the use of a single symbol, number or letter in volatility ratings. If

ratings are designated by a single number or letter supplied by a rating agency, investors are less likely to read the accompanying narrative disclosure, said Burstein. "The investor will quickly look at the A-rating and make a decision based on that," he said. Investors should evaluate the bond fund on the basis of their own investment objectives and risk tolerances, and not on the basis of a rating, the ICI letter stated. In addition, if the rule is approved, the ICI stated the SEC should approve proposed timeliness requirements designed to ensure that investors do not receive stale volatility ratings.

SEC Charges IA Prez With Unfair Trade Allocations

The **Securities and Exchange Commission** has charged the president and sole employee of an investment adviser with unfairly allocating profitable trades to his own accounts and failing to maintain contemporaneous records of client trades. The SEC said the day trades **Seth Gerson** of Thornwood, N.Y.-based **Gerson Asset Management** made were almost uniformly profitable, while client trades were overwhelmingly unprofitable. This suggested Gerson was engaging in deliberate conduct, said **Leslie Kazon**, SEC assistant regional director of in New York.

From May 1, 2000, to Feb. 29, 2004, Gerson purchased securities in an omnibus account early in the trading day and after watching whether the security appreciated, allocated the profitable day trades to his own accounts, the SEC's administrative proceedings and cease-and-desist order stated. Gerson also allocated the intra-day gain from client trades referred to him to his own accounts. Kazon said a red flag was the failure of Gerson to keep records of the date and time of each client trade, as required by the Investment Advisers Act. The SEC said Gerson misrepresented on his Form ADV that his firm kept records whenever a firm employee traded securities recommended to clients. The order also stated Gerson profited by $214, 280 and caused client losses of $150,000. Gerson's conduct represented an obvious breach of fiduciary duty, including at a minimum, the failure to disclose conflicts of interest, said Kazon.

Gerson agreed to a settlement with the SEC without admitting or denying the order's findings. The SEC revoked Gerson Asset Management's registration as an adviser and barred Gerson from association with a broker/dealer or adviser. Any reapplication for association by Gerson is subject to the condition that he pays all disgorgement and penalties. The SEC ordered Gerson to pay disgorgement of $160,237. Calls to **David Rosenfield**, counsel at **Herrick Feinstein** in New York and counsel for Seth Gerson and Gerson Asset Management, were not returned by press time.

Global Money Laundering Watch

U.K. Regulator Reminds Firms They Are Used For Laundering

A U.K. financial crime official has reminded the industry that some of the billions in laundered money in the country are routinely going through financial services firms. **Philip Robinson**, financial crime sector leader for the **Financial Services Authority**, told a **British Bankers' Association** forum Tuesday that £25 billion ($43.7 billion) is laundered annually in the U.K. Inevitably, dirty money that is not easy to spot is flowing through firms, Robinson said. He said it is hidden by all the legitimate business creating a challenge for firms to detect it.

Robinson suggested the industry maximize resources to target laundering and other financial crimes by continuously reviewing internal controls. He suggested sticking with "good basics" such as looking for investments that do not fit customer profiles, their investment goals or histories. Robinson said it is not necessary to turn front-line staff into law enforcement but noted communication among firms also helps because criminals share information.

In addition, Robinson reminded that laundering control failures can lead to enforcement. He mentioned a case last month against a firm that was introducing customers to a bank without providing the bank with information on who the customers were and where the funds they were investing originated. The FSA fined the firm £175,000 ($306,000) and its managing director £30,000 ($52,000) for failings in money laundering compliance.

Clarification For Proposal On Names Sought

The **Securities Industry Association** is seeking clarification on a proposed **Depository Trust Company** rule involving customer name screenings. The proposal is based on guidance from the **U.S. Treasury Department**'s **Office of Foreign Assets Control**. It provides specific requirements for the DTC and broker/dealers to screen names of the parties involved in deposits against OFAC lists. In a comment letter to the **Securities and Exchange Commission**, the SIA recommended that the SEC allow for reasonable time to implement the rule. It said firms will have to make considerable changes to comply that could take as much as 180 days to implement.

The SIA also asked for clarification about a section of the rule that would require firms to screen the names of parties who register the certificates as well as prior holders. The letters states that screening requirements might be problematic for firms that will not have ready access to information on previous

owners. The SIA said the rule should also stipulate that clearing brokers are not responsible for gathering information about certificate registration names. Instead clearing firms should be allowed to rely on information from introducing brokers.

The SIA said it would also like to see guidance on how firms should comply with their obligations under Regulation S-P when responding to possible OFAC matches found by the DTC. Regulation S-P imposes requirements for financial institutions regarding the treatment of customer information. Under the proposed rule the DTC would give firms information about possible matches through an automated system. The firms would then have to respond with information proving the customer is not the person on the list. The SIA would like the SEC to clarify that a firm will not be in violation of Reg S-P if it gives information relating to a possible OFAC match. **Karen Kupersmith**, director of NYSE arbitration, said the rule was designed to create more transparency and a more level playing field in arbitrator selection.

Europe

FSA To Review Effectiveness Of Mortgage, Insurance Regs…

The **Financial Services Authority** plans to review the effectiveness of recently introduced rules on mortgages, insurance and advice. The advice rules, called the depolarization regime, require firms that provide independent advice on mutual funds and other investments, to let customers pay for the advice through a fee or through commission. The reviews are planned for next year and will focus on how the rules have impacted firms and consumers, according to **David Kenmir**, managing director for regulatory services.

In remarks prepared for the FSA's annual training and competence forum in London last Tuesday, Kenmir said the reviews will have three goals. First, they will encourage feedback from firms and investors on what they think is effective or ineffective. Next, the FSA is aiming to do consumer research to see whether intended benefits are beginning to come through, such as consumers making good use of the information firms are now required to provide them. Third, they will aim to continue the FSA's reviews into whether the industry is complying with the rules.

Separately, FSA Chairman **Callum McCarthy** noted at a mortgage lenders' conference in London also on Tuesday that the vast majority of mortgage brokers have become licensed under the new mortgage rules that took effect this year. McCarthy said some mortgage lenders have been charging higher fees, which could violate the FSA's rules on fair treatment. The FSA's inspections of mortgages have focused on compliance with staff monitoring, client documentation and risk disclosure (CR, 8/8). Earlier inspections found several firms had inadequate procedures to monitor the advice staff gave customers.

…Sants Says EU Impact Assessments Can Go Further

Hector Sants

The **European Commission**'s plan to subject all new legislation to an impact assessment can be further extended, according to **Hector Sants**, managing director for wholesale and institutional markets at the U.K. **Financial Services Authority**. Sants said in a speech for a **Practising Law Institute** forum last Tuesday that the Commission's commitment to the assessments, which consist of an analysis of how an EU-wide proposal will affect regulated entities, makes a great deal of sense. He said it gives member states more of a voice.

But Sants said the Commission should consider extending these assessments to the whole life cycle of a proposed legislation. Sants said impact analysis could be used more to give member states options to tailor regulations better to their regimes. He added there could be more leeway given to EU members to decide whether to implement a rule as such or to decide whether they can put in place methods for conforming with an EU standard rather than making a new rule. Sants added he also backs the EU's idea to review existing measures for redundancies. EU spokespersons were not available by press time.

Regulatory Alert

The following is a roundup of selected current regulatory proposals, notices and directives collected from official bulletins and other sources which are deemed reliable. The chart is updated each issue. To notify CR of new measures call ***Mark Malyszko*** *at (212) 224-3281, fax: (212) 224-3686 or e-mail mmalyszko@iinews.com.*

North America

Regulator	Date	Topic	Particulars	Status
Committee of Sponsoring Organizations for the TreadwayCommission	Oct-05	Internal controls	Published for comment guidance on using its framework to address the needs of smaller businesses under the Sarbanes-Oxley Act's Section 404 on internal controls. The guidance lays out 26 elements of financial controls and how to insure they are adequate.	Comments due Dec. 31.
Securities and Exchange Commission	Dec-05	Accounting requirements	Commission issued guidance for accounting of sales of vaccines and bio-terror countermeasures to federal government.	Became effective Dec. 5.
SEC	Oct-05	Disgorgements	Adopted a rule allowing the Secretary of the Commission to waive a requirement for the administrator of a disgorgement fund to obtain a bond to protect against the disgorgement fund losing value. The requirement can be waived if the fund is held at the U.S. Department of the Treasury.	Became effective Nov. 21.
SEC	Sep-05	Soft commissions	Published for comment interpretive guidance concerning the soft commission safe harbor in Section 28(e) of the Securities Exchange Act of 1934. The guidance clarifies that the safe harbor is limited to brokerage and research services that satisfy eligibility criteria and that commissions are reasonable in relation to the vale of the products and services provided.	Comments were due Nov. 25.
SEC	Jun-05	Fund governance	SEC reapproved by a rule requiring mutual fund boards to be 75% independent with an independent chairman.	Becomes effective Jan. 16.
SEC	Jun-05	Securities offerings	Published the approved securities offering reform rule to modify communications related to securities offerings, information delivery and procedures for during the offering process.	Became effective Dec. 1.
SEC	Jun-05	Market structure	Released final version of Regulation NMS, which contains four related rule proposals intended to modernize equity markets. These include the trade-through rule that will require trading centers to obtain the best price for investors when that price is represented by an immediately accessible automated quotation. It would also prevent market participants accepting quotes priced in increments of less that $0.01.	Trade-through rule becomes effective June 12, 2006. Sub-penny rule became effective July 1. Compliance date for sub-penny rule extended to Jan. 31, 2006.
NASD	Nov-05	OTC	SEC approved rule change that would prohibit members from quoting issuers on the over-the-counter (OTC) bulletin board that have been delinquent in their filing obligations.	Becomes effective shortly.
NASD	Nov-05	CEO certification	Filed with SEC amendments to Rules 3012 and 3013 which extend until April 1 the date by which members must submit their annual report required by Rule 3012 and CEO certification required by Rule 3013.	Became effective immediately.
NASD	Oct-05	Short interest reporting	Filed with the SEC a proposal to amend rule 3360 to extend short interest reporting to include over-the-counter (OTC) equity derivatives. The proposal would require firms to maintain a record of all short positions in OTC equity derivatives and report those positions to the NASD.	Comments were due Nov. 25.
			regulators and clearing firms to distinguish between data belonging to an intermediary firm and a piggybacking firm.	Effective Feb. 20.
NASD	Oct-05	Customer market orders	SEC approved Rule 2111 that prohibits firms from trading ahead of customer market orders in certain circumstances.	Becomes effective Jan. 9.
NASD	Oct-05	Limit orders	SEC approved amendment to IM-2110-2, commonly known as the Manning rule, to require members to provide price improvement to customer limit orders in certain circumstances.	Becomes effective Jan. 9.
NASD	Sep-05	Exams	Filed with SEC changes to Series 4, Series 6 and Series 9/10 exams.	Became effective Nov. 30.
New York Stock Exchange	Dec-05	Listing standards	Filed with SEC a pilot program relating to the Exchange's Listed Company Manual to allow company's emerging from bankruptcy the ability to list if they have 400 round lot holders prior to the start of trading.	Effective immediately .
NYSE	Dec-05	Arbitration	SEC approved a change to Rule 607 that will allow customers involved in arbitration the option of selecting arbitrators from a random list.	Became effective immediately .
NYSE	Nov-05	Specialists	SEC approved exemption under NYSE Rule 460 that restricts transactions between a specialist and any company in whose stock the specialist is registered. Exemption applies to specialists and the sponsor of Exchange Trade Funds.	Becomes effective shortly.

North America

Regulator	Date	Topic	Particulars	Status
Financial Crimes Enforcement Network	Nov-05	Insurance	Published final version of amendments to the Bank Secrecy Act that requires certain types of insurance companies to have anti-money laundering procedures and to file Suspicious Activity Reports (SARs). Also published Insurance SAR form for comment.	Became effective Dec. 5. Comments on SAR form due Jan. 3.
Canadian Securities Administrators	Oct-05	Prospectuses	Adopted National Instrument 44-101 that reorganizes the short form prospectus system to deal with deficiencies under current rules and broadens access to the short form prospectus.	Becomes effective Dec. 30.

Europe

Regulator	Date	Topic	Particulars	Status
International Organization of Securities Commissions	Oct-05	Debt securities	Proposed international disclosure standards for documents used in the public offering of corporate debt securities. The standards include disclosing the firms and individuals involved in issuing the security.	Feedback due Dec. 22.
European Commission	Nov-05	Transparency	Proposed detailed rules to implement the Transparency Directive. The rules include requirements to disclose large purchases or sales of shares in public companies and also include requirements on what should be included in public companies' half-yearly financial reports.	Feedback due Jan. 8.
European Commission	Nov-05	Financial Services Action Plan	Requested comments on how effective the Commission has been at implementing the Financial Services Action Plan (FSAP) a five-year plan to harmonize EU rules. The Commission wants to know how it can improve the rulemaking process for future directives.	Feedback due Jan. 31.
Committee of European Securities Regulators	Oct-05	Cross-border fund sales	Proposed rules to streamline the process through which EU fund managers obtain permission from regulators to sell funds cross-border. The proposals include creating a standard set of disclosure documents for fund managers to give regulators.	Feedback due Jan. 27.
CESR	Sep-05	Mediation	Proposed a mediation mechanism that would help resolve disputes between EU regulators over how to implement European regulations. Under the proposals CESR would appoint so-called gatekeepers to assess the dispute and guide regulators towards a resolution.	Feedback was due Nov. 30.
Financial Services Authority (U.K.)	Oct-05	Reinsurance contracts	Proposed that insurers should disclose their use of so-called financial reinsurance contracts, which are used to smooth out volatile profits. Disclosure is needed because some firms may be using the contracts to artificially inflate profits.	Feedback was due Dec. 7.
FSA	Oct-05	Soft commissions	Proposed that retail investment funds, including mutual funds, should disclose their use of soft commissions to a firm or individual, such as an independent director, who should review the disclosure on behalf of investors.	Feedback due Jan. 6.
FSA	Sep-05	Bond trading	Issued a discussion paper seeking comment on whether firms should have to disclose to the market the price at which they trade certain bonds. The paper does not propose rules and is intended to spark discussion in advance of a European Commission consideration to introduce rules.	Feedback was due Dec. 5.
FSA	Jul-05	Soft commissions	Published final rules requiring that soft commissions can only be used to purchase services related to research and execution. The rules also require firms to disclose what percentage of commission is used to pay for research.	Becomes effective Jan. 1.
HM Treasury	Oct-05	Pensions	Proposed changes to the Financial Services and Markets Act that would simplify the process of establishing and operating a pension scheme. The changes include allowing new pension schemes to register with U.K. tax authorities via the Web.	Feedback due Dec. 23.

Asia

Regulator	Date	Topic	Particulars	Status
Securities and Futures Commission (Hong Kong)	Oct-05	Money laundering	Published revised anti-money laundering guidance for firms and banks. The guidance includes that firms should take a risk-based approach by performing extra ID checks on high risk customers. It also makes changes to record-keeping and reporting requirements.	Becomes effective April 30.
SFC	Aug-05	Prospectuses	Proposed a series of possible reforms to prospectus rules. The proposals include possible restrictions on publishing research before an initial public offering to prevent information not included in the prospectus from being leaked to the public.	Feedback was due Nov. 30.
Dubai International Financial Centre	Nov-05	Collective investments	Approved a law that provides a framework for the creation of trusts in the centre.	Effective date to be announced.

Briefs

The following is a summary of selected press announcements, enforcement actions and news reports as posted on CR's Web site throughout the previous week. The information has been obtained from sources believed to be reliable but CR does not guarantee its completeness or accuracy.

Regulation

● The **Canadian Securities Administrators** launched a survey to seek input on how to make the System for Electronic Disclosure by Insiders more user friendly. "We are currently investigating ways to make SEDI easier to use," **Jean St-Gelais**, chair of the CSA and president of the **Autorité des marchés financiers du Québec**, said in a statement. "As part of this process, regulators from coast to coast encourage all SEDI users and interested parties to participate in research on how the system can be improved or streamlined." The electronic filing system, launched in June 2003, is far more efficient than its precursor, a paper and fax based system, and it provides for accurate, detailed information for regulators and the investing public, said St-Gelais.

● The heads of the **Dubai Financial Services Authority** and U.S. **Commodity Futures Trading Commission** reached a regulatory protocol. The CFTC is the home regulator of **NYMEX**, which has announced its intention to establish the **Dubai Mercantile Exchange** in a joint venture with **Dubai Holding**, the commercial arm of the Dubai Government next year. DME is in discussions with the DFSA and is finalizing its license application. "The relationship between DFSA and CFTC will be important to ensure effective and coordinated regulation of the proposed DME," said DFSA Chief Executive **David Knott** in a statement. Knott and CFTC Chairman **Reuben Jeffrey III** signed the agreement at a ceremony in New York.

● The **Financial Services Authority** has agreed with the **British Bankers' Association** and **Building Societies Association** on changes to industry practice that will help reduce the risk that checks made payable just to a bank or building society can be intercepted by a fraudster and paid into his or her account. Following a recent incident of this kind of fraud, the FSA entered into discussions with the industry on how best to change check handling practices. As a result, the banks and building societies have decided that from Sept. 30, 2006, the industry will in a range of circumstances stop accepting checks made payable simply to a financial institution. From next year, people will need to add further details, such as the name of the person whose account is to be credited, to the payee line of checks that are payable to a bank or building society.

● The **NASD** has notified its members that the SEC has issued Fee Rate Advisory #5 for Fiscal Year 2006. Effective Dec. 22, the revised Section 31 transaction fee rate will decrease to $30.70 per million. The Commission is required to adjust the filing and securities transaction fee rates on an annual basis, after consultation with the Congressional Budget Office and the Office of Management and Budget. A copy of the Commission's April 30, 2005, order regarding the fee rate adjustments is available at www.sec.gov/news/press/2005-69.htm

People

● The **Securities and Exchange Commission** has named **Willis Gradison**, a former Ohio congressman, as the acting chairman of the **Public Company Accounting Oversight Board**. The SEC also adopted procedures for the selection of permanent chairpersons and Board members. Gradison, a founding member of the Board, has served as the chairman of the **Federal Home Loan Bank of Cincinnati**, an investment broker, and a corporate director. He replaces outgoing Chairman **William McDonough**. Gradison was a member of Cincinnati City Council for 13 years, from 1961 to 1974, serving as vice mayor from 1967 to 1971 and mayor in 1971. In Congress, Gradison served as ranking member of the House Budget Committee. Under the new selection procedures, the SEC chairman will lead a search to identify qualified candidates and will solicit nominations and input from each of the SEC's current commissioners, who may each submit up to three nominations.

● The SEC said that **Meyer Eisenberg**, deputy general counsel and acting director of the Division of Investment Management, will resign effective in January. Eisenberg has been SEC deputy general counsel since 1998. Eisenberg has accepted a job as visiting professor of law at **Willamette University** of Law in Salem, Ore. As deputy general counsel, Eisenberg was involved in a number of major Commission rulemaking proceedings and litigation matters, including rules related to the implementation of the Sarbanes-Oxley reforms, including the rules relating to lawyers and their responsibilities.

● **Michele Layne** has been named an associate regional director for enforcement in the SEC's Pacific Regional Office, in Los Angeles. Layne replaces **Sandra Harris**, who left the SEC in September to return to the private sector. Layne will serve as co-head, with **Briane Mitchell**, of the Los Angeles office's enforcement program. During her 10-year tenure at the SEC, Layne has played a key role in directing a number of enforcement actions, including cases against over a dozen former executives of **Homestore, Inc.**, including the former CEO and chairman of the board, for fraudulent round-trip transactions to inflate the company's online advertising revenues.

BONUSES UP

(continued from page 1)

compliance officers at hedge funds in 2005 a compensation package that includes bonuses 25-35% of their base salary. For example, a mid-level compliance officer earning $135,000 would probably get a $40,000 bonus. A chief compliance officer at a mid-sized hedge fund could potentially earn a base salary of $225,000 with a bonus of $75,000. Lord noted that some bonuses have gone as high as 50% of the salary.

Daniel Solo, a compliance recruiter at the **Response Cos.** in New York, said in 2005 a compliance officer with five years experience at a hedge fund earning a base salary of $100,000-130,000 could potentially earn a 25-30% bonus. He said bonuses appear to be up overall on the asset management side in 2005, especially for compliance officers with alternative investment or fund-of-fund experience. He attributed the increase to the difficulty for firms to find qualified people.

Bonuses for B/D and IA compliance officers will be in the 15-30% range for those with base salaries of $100,000 in 2005, said **Michael Tuller**, director of executive search for the **Compliance Search Group** in New York. Tuller said this year more senior level people earning a base salary of $200,000 could probably expect bonuses of 50% or higher.

Solo noted that some more specialized compliance officers at B/Ds, such as those with expertise in investment banking might see an increase of about 5% over 2004. That would give a person with five years experience at an investment bank making a salary between $90,000-110,000 in 2005 a bonus of about 25%, he said. Solo said most B/D compliance officers are not expecting too much of an increase in bonuses over 2004, but nobody is expecting a decline in compensation. ***—C.Z.***

PENSION CONSULTANTS

(continued from page 1)

Compliance Inspections and Examinations, told *CR*. Firms that have insulated pension consulting from other parts of their business have taken an important step that satisfies the regulators, she added.

The survey was a follow-up to an SEC staff report published in May on the results of exams of 24 pension consultants. That report revealed potential conflicts, such as consultants not regarding themselves as fiduciaries to their clients and a majority of consultants had affiliated broker/dealers, said Richards. The survey showed advisers have undertaken organizational changes to prevent the sharing of information about pension consultant clients with other parts of the firm, Richards said.

For example, one pension consultant appointed two different people to head its consulting and asset management divisions, which were previously led by one person. Richards noted a number of consultants had ended their affiliation with B/Ds, while others closed their broker/dealer subsidiaries.

"The survey provides an update with real concrete steps pension consultants are taking," Richards said. "We really published the results to reach the pension consultants we did not examine."

Richards noted many consultants are providing greater disclosure of potential conflicts on Part II of the Form ADV and others have created a document supplementing Form ADV discussing how potential conflicts are managed. In response to SEC recommendations, pension consultants have also created policies and procedures to prevent conflicts with respect to brokerage commissions, gifts, gratuities, entertainment, contributions and donations, Richards said. Firms have, for example, imposed restrictions in their code of ethics on which employees may give and receive gifts and the dollar amount of those gifts. ***—E.L.***

SEC RESTRICTS

(continued from page 1)

adviser, general partner or personnel withdraw their own investments from the fund during the lockup period, they will cause the fund to fall within the definition of a "private fund." As a result, they will trigger the requirement for the fund to register with the SEC. The SEC's Division of Investment Management provided the guidance in a no-action letter to an **American Bar Association** subcommittee that sought the clarification. Prior to the no-action letter's release, **Robert Plaze**, associate director in the SEC's Division of Investment Management, told *CR* the intention of the SEC rule is to require hedge funds to register, whereas the industry has been "busy looking for ways to avoid registration."

The SEC rule passed last December requires hedge fund managers with 14 or fewer clients to either register or establish the so-called lockup through which new investors would agree not to withdraw their investments for two years. The SEC created the lockup option so that private equity funds, which typically have lockup periods of several years, would not be caught in the registration requirements. The no-action letter was co-signed by Plaze and **Douglas Scheidt**, the division's chief counsel.

A lawyer serving on the ABA subcommittee said in addition to encouraging registration, the SEC's other rationale for more restrictions is that insiders should not get a better deal than outside investors. In the past, the understanding was that only outside investors were bound by the two-year lockup to keep their investments in the fund. The adviser and its personnel typically make significant proprietary

investments in the fund, the lawyer said. "Investors want to see that."

The letter explains the SEC did not want to allow the adviser and its personnel to greater flexibility in redeeming their investments than outside investors. The letter stated:

"Such an exclusion would have encouraged insiders to take for themselves preferential liquidity terms that they do not extend to the investors to whom the insiders owe a fiduciary duty, and would not further the rules' objective of investor protection."

The lawyer noted, however, the adviser and its personnel will still be able to withdraw investments made prior to Feb. 1 of next year. The SEC showed more flexibility by allowing the adviser to withdraw from the fund incentive fees it has earned.

—Elizabeth LeBras

COMMISSION CONSIDERS

(continued from page 1)

lawyers said that the rest of the B/D community would have to change how it does its accounting. If accountants have to follow different procedures then by default PCAOB standards would be thrust upon the B/Ds.

The move would also be a shift in policy. Officials from the Division of Market Regulation have said that they have no plans to recommend that accounting standards apply to B/D auditors (CR, 5/23). The notice, however, comes from the commissioners. The SEC noted the consideration at the end of an order that on Wednesday extended an exemption until Jan. 1, 2007 under which B/Ds do not have to use auditors subject to PCAOB standards. Spokesmen for the SEC and PCAOB were unaware of whether the Commission has yet or plans to contact the Board about the concept release. "As always if the SEC asks we will be happy to help in any way we can," said the PCOAB's **Michael Shokouhi**. **John Heine**, SEC spokesman, added there is no timeframe for the release.

Hardy Callcott, a former assistant general counsel in the division, said if a registered public accounting firm were to audit a non-public B/D, the auditors would hold it to higher standards. Some standards, such as those included in Section 404 of SOX would not be easy to meet, said Callcott, a partner at **Bingham McCutchen** in San Francisco. The PCAOB standards are filled with a host of procedural requirements. Callcott noted that for example, public companies must have different designees for signing off on different types of financials whether contracts or filings—a policy that does not exist for the mid-sized and small B/Ds who may have one person keeping track of financials.

The idea surprised lawyers and B/Ds. They said the SEC could be backing itself into a corner with it. The Commission's authority to extrapolate requirements from SOX to B/D auditors could be challenged, noted **Stanley Keller**, partner with **Edwards Angell Palmer & Dodge** in Boston. Callcott said it could be a tough decision. "They're going to be criticized no matter which way they go with this," he said. A CEO of a small B/D said it would not be practical for the PCAOB to regulate accountants for thousands of B/Ds. "They have enough challenges," he said.

—Curtis Zimmermann & Mark Malyszko

Quote Of The Week

"They're going to be criticized no matter which way they go with this."—**Hardy Callcott**, *partner at* ***Bingham McCutchen*** *in San Francisco, on the* ***Securities and Exchange Commission*** *considering registering auditors of non-public broker/dealers (see story, page 1).*

One Year Ago In Compliance Reporter

Sharon Brown-Hruska, then acting chairman of the **Commodity Futures Trading Commission**, said joint regulation of the single stock futures markets by the CFTC and **Securities and Exchange Commission** impeded the development of the markets and should be reassessed by Congress. [The CFTC and SEC continue to jointly regulate single stock futures. In September, **Robert Colby**, deputy director of the SEC's Division of Market Regulation, told Congress the pending reauthorization of the CFTC should not give the CFTC disproportionate authority over the markets for securities futures products (CR, 9/12). In August, the CFTC named **Reuben Jeffery** chairman of the CFTC, while Brown-Hruska still serves as a commissioner.]

Bar Stool

No One Watching The Gate

New York-based hedge fund **Millennium Partners** deployed sticky assets to gain market timing capacity, according to orders filed by the **Securities and Exchange Commission** and New York Attorney General **Eliot Spitzer**. Sticky assets refer to deals in which long-term investments are made in mutual funds in exchange for market timing capacity. But **Steven Markovitz**, a trader later dismissed by Millennium, deemed such investments as "bribes" and a waste of money, according to Spitzer's complaint. In an e-mail dated Jan. 2, 2003 to a Millennium manager, Markovitz said municipal bond funds did not need to be bribed because they would not notice market timing activity. "You don't have to post bribe money to play these funds, mainly because no one is watching the gate," he wrote. Millennium settled market timing charges with the SEC and Spitzer's office on Dec. 1. Millennium and its personnel were ordered to pay more than $180 million in disgorgement and penalties.