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SEC – Recent Developments:
Actions taken at Open Meeting December 13, 2006

At an open meeting of the Securities and Exchange Commission (“SEC”) held December 13, 2006, the SEC took the following significant actions:¹

I. Adoption of e-Proxy Rule Amendments

Rule amendments were adopted pursuant to which a company may, but will not be required to, furnish proxy materials to shareholders through such company’s internet website. A “Notice of Internet Availability of Proxy Materials” will be required to be sent to shareholders at least 40 days before a meeting. A proxy card may not accompany the Notice. Shareholders may make a permanent election to receive all proxy materials in paper or by e-mail with respect to future proxy solicitations conducted by the company. The compliance date for the new rules is July 1, 2007. Persons may not comply with the new rules before that date.

II. Proposed Rules Affecting Pooled Investment Vehicles

Rules were proposed which would (i) prohibit false or misleading statements by investment advisers to certain pooled investment vehicles, and (ii) amend the definition of “accredited investors” to add an additional category for individuals to be eligible to invest as accredited investors in certain private investment vehicles.

- A rule proposed under the Investment Advisers Acts of 1940 would make it a fraudulent practice for an investment adviser to a pooled investment vehicle to make false or misleading statements or otherwise defraud investors or prospective investors in that pool. The proposed rule would apply to all investment advisers whether they were registered or not and would apply to all investment vehicles including those relying on Section 3(c)(1) or 3(c)(7) for exemption from registration under the Investment Company Act of 1940.

¹ A webcast of the open meeting is available on the SEC website at <http://www.connectlive.com/events/sec-openmeetings/>. Full releases of the rules adopted or proposed and the guidance announced will be posted on the SEC website in the near future.

Among the practices this rule is directed at is the practice of entering into side letters with specific investors in these vehicles where such side letters have not been disclosed to the other investors.

- A proposed rule would add a new category of “accredited investor” applicable to individuals for purposes of investments in a hedge fund or other private investment pool. The new category would require that a person must meet the existing accredited investor tests applicable to individuals and, in addition, own at least \$2.5 million in investments as defined in the proposed rules.

III. Proposed Rules Allowing Lightly Traded Foreign Private Issuers to Deregister under the Exchange Act

Rules which would allow lightly traded foreign private issuers to deregister under the Securities Exchange Act of 1934 (the “Exchange Act”) more easily were re-proposed. The proposed rule (Exchange Act Rule 12h-6) would permit a foreign private issuer to deregister if the U.S. average daily trading volume of the subject class of securities has been no greater than 5% of the average daily trading volume of that class of securities in the issuer’s primary trading market during a recent 12 month period. The rule would require an issuer that de-lists in the U.S. prior to deregistering to meet the trading volume standard at the date of de-listing or else wait 12 months before it can proceed with deregistration in reliance on the proposed trading volume standard. It would also require an issuer that terminates an American Depository Receipts facility to wait 12 months before seeking deregistration under the rule in reliance on the trading volume standard.

Further, proposed rule amendments to Rule 12g3-2(b) would permit a foreign private issuer to claim the exemption under that rule immediately upon terminating its Exchange Act reporting, rather than having to wait 18 months as is currently required. The exemption would be allowed on condition that the issuer publish in English its home country materials required by Rule 12g3-2(b) on its internet website or through an electronic information delivery system that is generally available to the public in its primary trading market.

IV. Proposed Interpretive Guidance on SOX 404

The SEC proposed interpretive guidance for managements of issuers to improve SOX Section 404 implementation. The proposed guidance is principles-based and is organized around the following two principles:

- First, management should evaluate the design of the controls that it has implemented to determine whether there is a reasonable possibility that a material misstatement in the financial statements would not be prevented or detected in a timely manner.
- Management should gather and analyze evidence about the operation of the controls being evaluated based on its assessment of the risk associated with those controls.

The guidance further addresses four specific areas which have been of concern since the implementation of SOX 404.

- *Identification of risks to reliable financial reporting and the related controls that management has implemented to address those risks.* The proposed guidance describes a risk-based approach that would require the use of judgment to determine those areas that are both material and a risk to reliable financial reporting. The guidance would not require that every control in the process be identified. Once the controls are identified that adequately address the risk of material misstatement in the financial statements, it would be unnecessary to include additional controls within management's evaluation.
- *Evaluation of the operating effectiveness of controls.* Once management has determined the controls within the scope of its evaluation, management would then gather and analyze evidence about the operation of those controls. Again the guidance provides for a risk-based approach that would require the use of judgment to direct management's evaluation efforts toward those areas that pose the greatest risk to reliable financial reporting based on the company's unique facts and circumstances.
- *Reporting the overall results of management's evaluation.* Once management has completed its evaluation, management must decide if any identified control deficiencies are material weaknesses. The guidance describes the factors that management should consider to evaluate the severity of the deficiency. If the deficiency is a material weakness, consistent with the SEC's existing rules, management must conclude that internal control over financial reporting is not effective and management has reporting responsibilities surrounding that material weakness.
- *Documentation.* The proposed guidance explains the nature and extent of evidential matter that management must maintain and support of its assessment. Management is given flexibility in approaches to documentation. The proposed guidance indicates that such documentation can take many forms, can be presented in a number of ways, and does not need to include all controls within a process that affects financial reporting.

The SEC announced that it had worked on its guidance with the Public Company Accounting Oversight Board ("PCAOB") and as part of that effort, the PCAOB intends to consider proposing a new auditing standard to supersede Auditing Standard No. 2 at the PCAOB's open meeting to be held on Tuesday, December 19, 2006.

V. Bank Broker Provisions to be Proposed Jointly with Federal Reserve Board

The SEC voted to issue jointly with the Board of Governors of Federal Reserve System rules for comment to implement bank-broker provisions of the Exchange Act. The proposed rules would define certain statutory terms in the areas of third-party brokerage ("networking"), trust and fiduciary activities, safekeeping and custody and sweep accounts. They would provide banks with conditional exemptions to accommodate certain limited bank securities activities. In addition, the proposal would provide banks with an exemption from possible third-party rescission rights for acting as an unregistered broker, as well as a related transitional exemption. In conjunction with this proposal, the Commission extended the exemption for banks from the definition of "broker" in the Exchange Act until July 2, 2007.

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or e-mail Jonathan I. Mark at (212) 701-3100 or jmark@cahill.com; John Schuster at (212) 701-3323 or jschuster@cahill.com; or Arthur Dobelis at (212) 701-3359 or adobelis@cahill.com.