

SEC Update:

New Enforcement Initiatives Expected to Improve Timeliness and Quality of Information; SEC Proposes to Allow WKSIs to Name Reps to Contact Investors; SEC Revises Custody Rules for Client Assets Controlled by Investment Advisers; Model Privacy Notice Jointly Released

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New Enforcement Initiatives Expected to Improve Timeliness and Quality of Information

On January 13, Robert Khuzami, the Director of the Securities and Exchange Commission's Enforcement Division, announced new enforcement initiatives in an effort to improve the quality, quantity, and timeliness of the information that the SEC receives from individuals and/or entities.¹ Director Khuzami described the new initiatives as a "potential game-changer for the Division of Enforcement."²

The new SEC enforcement initiatives include:

1. Implementing various tools not previously available in SEC enforcement matters. The

new tools, which will be used in an effort to encourage individuals and companies to report violations and provide assistance to the SEC, include cooperation agreements, deferred prosecution agreements, and non-prosecution agreements. Each of these tools are available to the Department of Justice in its criminal investigations and prosecutions;³

2. Streamlining the "process for submitting witness immunity requests to the Department of Justice for witnesses who have the capacity to assist in its actions and related enforcement actions"⁴; and
3. Rewarding cooperating individuals/entities based upon the (1) assistance provided by the cooperating individual, (2) importance of the underlying matter in which the individual cooperated, (3) societal interest in ensuring that the individual is held accountable for his or her misconduct, and (4) appropriateness of cooperation credit based upon the risk profile of the cooperating individual."⁵

The enforcement initiatives are further described in the new Section 6 of the Enforcement Manual entitled, "Fostering Cooperation."⁶

SEC Proposes to Allow WKSIs to Name Reps to Contact Investors

On December 22, the SEC proposed amendments to Rule 163 under the Securities Act to further facilitate certain large companies to communicate, via representative, with broader groups of potential investors and gauge the level of interest in the market for their potential securities offerings.

The proposed amendments⁷ would apply to companies that are "well-known seasoned issuers" (WKSIs) and would now allow them to select a representative—such as an underwriter or dealer—to contact potential investors concerning potential securities offerings *before* having to file registration statements for such offerings. Under the current Rule 163, only WKSIs are permitted to communicate directly with potential investors before filing a registration statement.

A WKSI is an issuer that is current and timely in its Exchange Act reports for at least one year and has either \$700 million of publicly-held shares or has issued \$1 billion of non-convertible securities, other than common equity, in registered offerings for cash in the preceding three years.

According to a press release⁸ describing the amendments, as proposed, an underwriter or dealer could act as an agent or representative of a WKSI if the following conditions are satisfied:

- The underwriter or dealer receives written authorization from the WKSI to act as its agent or representative before making any communication on its behalf.
- The WKSI authorizes or approves any written or oral communication before it is made by an authorized underwriter or dealer.
- Any authorized underwriter or dealer that has made any authorized communication on behalf of the issuer in reliance on Rule 163 is identified in any prospectus contained in the registration statement that is filed for the offering to which the communication relates.

Public comments on the rule amendments proposed must be received by the Commission by January 27, 2010.

SEC Revises Custody Rules for Client Assets Controlled by Investment Advisers

On December 16, the SEC adopted rules seeking to substantially increase the protections for investors who turn their money and securities over to an SEC-registered investment adviser.⁹ According to the press release, “[t]he new rules provide safeguards where there is a heightened potential for fraud or theft of client assets.” The rule amendments are effective March 12, 2010.

According to the release, most investment advisers do not maintain physical custody of their clients’ assets—instead, those assets are held by a qualified third-party custodian, such as a regulated bank or a broker-dealer. The SEC stated that in the past year, it had brought a series of

enforcement cases against advisers who had access to their clients’ assets and allegedly misused them. The SEC claimed that these advisers often covered up the misuse by distributing false account statements to their clients reflecting assets that didn’t really exist.

The SEC’s amended custody rule seeks to promote independent custody and require the use of independent public accountants as third-party monitors. Depending on the investment adviser’s custody arrangement, covered advisers would be required to be subject to a surprise exam and custody controls review that are generally not required under existing rules. Specifically:

- **Surprise Exam**—If the adviser has custody over client assets, it will now be required to engage an independent public accountant to conduct an annual “surprise exam” to verify that client assets exist, and the accountants would have to contact the SEC if they discovered client assets were missing.
- **Custody Controls Review**—In addition, the adviser will now be required to obtain a written report prepared by an accountant registered with the Public Company Accounting Oversight Board (PCAOB). The report (commonly known as a SAS-70 report), among other things, would describe the controls in place at the custodian, tests the operating effectiveness of those controls and provides the results of those tests. The new rules also require that:
 1. For all hedge funds and other private funds that comply with the custody rule by obtaining an audit of the fund and delivering the fund’s financial statements to fund investors, the auditor of such a private fund must be PCAOB-registered.
 2. The adviser reasonably believes that the client’s custodian delivers the account statements directly to the client.

Model Privacy Notice Jointly Released

On November 17, the Board of Governors of the Federal Reserve System, the Commodity Futures Trading Commission, the Federal Deposit

Insurance Corporation, the Federal Trade Commission, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the SEC jointly issued a final model privacy notice form under the Gramm-Leach-Bliley Act (GLB).¹⁰ The new form became effective December 31, 2009.

GLB requires financial institutions to disclose their information-sharing practices to their customers and also to notify those customers of their right to opt-out of certain practices. As amended by the Financial Services Regulatory Relief Act of 2006, the GLB also requires that certain regulatory agencies develop a model privacy notice form. This privacy notice form is intended to assist consumers in comparing the different information and privacy practices of financial institutions by providing an inclusive form that is consistent across all institutions.

The final model privacy notice form, which is two pages, comes in three versions:

- model form with no opt-out;
- model form with telephone and Web opt-out only; and
- model form that includes a mail-in opt-out form.

Page 1 of the final model form has five parts:

- title;
- introductory section called the “key frame” which provides context to help the consumer understand the required disclosures;
- disclosure table that describes the types of sharing used by financial institutions consistent with Federal law, which of those types of sharing the institution actually does, and whether the consumer can limit or opt-out of any of the institution’s sharing;
- only if needed, a box titled “To limit our sharing” for opt-out information; and
- institution’s customer service contact information.

If the institution provides a mail-in opt-out form, that form appears at the bottom of Page 1. Page 2 of the final model form provides addi-

tional explanatory information that, in combination with Page 1, includes the elements required by GLB and the related privacy rules.

The agencies (other than the SEC) have eliminated the safe harbor previously permitted for notices based on the sample clauses contained in the earlier privacy rules if the notice is provided after December 31, 2010. The SEC has eliminated the guidance associated with the use of notices based on the sample clauses in its earlier privacy rule if the notice is provided after December 31, 2010.

NOTES

1. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
2. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
3. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
4. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
5. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
6. See SEC Press Rel. No. 2010-6 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-6.htm>.
7. See SEC *Revisions To Rule 163*; 17 Cfr Part 230 Release No. 33-9098; File No. S7-30-09; available at <http://www.sec.gov/rules/proposed/2009/33-9098.pdf>.
8. See Release 2009-273; *SEC Proposes Rule Amendments to Facilitate Access to Capital Markets*; available at <http://www.sec.gov/news/press/2009/2009-273.htm>.
9. See SEC Rel. No. IA-2968 (Dec. 30, 2009), available at <http://www.sec.gov/rules/final/2009/ia-2968.pdf> (adopting release); SEC Rel. No. IA-2969 (Dec. 30, 2009), available at <http://www.sec.gov/rules/interp/2009/ia-2969.pdf> (interpretive release); and SEC Rel. No. IA-2876 (May 20, 2009), available at <http://www.sec.gov/rules/proposed/2009/ia-2876.pdf> (proposing release). See also SEC Press Rel. No. 2009-269 (Dec. 16, 2009), available at <http://www.sec.gov/news/press/2009/2009-269.htm>.
10. See SEC Rel. No. 34-61003 (Nov. 16, 2009), available at <http://www.sec.gov/rules/final/2009/34-61003.pdf>. See also SEC Press Rel. No. 2009-248, available at <http://www.sec.gov/news/press/2009/2009-248.htm>.

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