

## SEC/SRO Update

### SEC Amends E-Proxy Rules; SEC Reaffirms Support for Global Accounting Standards; SEC Sets New Short Sale Price Test (Amendment of Regulation SHO); SEC Adopts Money Market Reform Rules

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#### SEC Amends E-Proxy Rules

On February 22, the Securities and Exchange Commission (SEC) revised the rules governing electronic access to proxy materials (e-proxy).<sup>1</sup> The amendments are designed to increase shareholder participation in the voting process, as well as to reduce shareholder confusion. The new rules will be effective as of March 29, 2010.<sup>2</sup>

The following summarizes the amendments to the e-proxy rules:

- Under the revised e-proxy rules, companies are no longer required to include certain boilerplate language that is currently mandated in the Notice of Internet Availability of Proxy Materials (the “Notice”). The revised rules instead require companies to include the following abbreviated legend in the Notice which states: “Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting To Be Held on [insert meeting date].” Although companies will

need to continue to include the information described below, the SEC has not prescribed the specific language that companies must use in the Notice in order to communicate: (a) that the Notice is not a form for voting; (b) that the Notice only provides an overview of the proxy materials; (c) that shareholders should review the proxy materials before voting; (d) the Internet Web Site address where proxy materials are available; (e) how shareholders may request a paper or e-mail copy of the proxy materials; and (f) that shareholders will not receive an e-mail or paper copy of the proxy materials unless they request such a copy.<sup>3</sup>

- Companies may include explanatory materials with the Notice that include companies’ reasoning for use of the notice-only method of deliver and the process by which shareholder may receive and review proxy materials and cast their votes under the e-proxy rules.<sup>4</sup>
- Companies are required to continue identifying the matters to be considered at the annual meeting, but the Notice does not need to have the same content or format as the proxy card.<sup>5</sup>

#### SEC Reaffirms Support for Global Accounting Standards

On February 24, after a unanimous vote, the SEC issued a statement confirming its support for “...a single set of high-quality globally accepted accounting standards, which would advance the dual goals of improving financial reporting within the U.S. and reducing country-by-country disparities in financial reporting...”.<sup>6</sup> Specifically, the SEC continues to consider incorporating International Financial Reporting Standard (IFRS) into the financial reporting system for U.S. issuers.

The SEC cautiously endorsed the use of IFRS by U.S. issuers, contingent upon reaching a number of milestones, including the convergence of U.S. GAAP with IFRS and improved governance of the International Accounting Standards Board.<sup>7</sup>

The SEC has directed its staff to execute a Work Plan, which will aid the SEC with its evaluation of the impact on the use of IFRS on the U.S. securities market.<sup>8</sup> The SEC indicated that it will provide public progress reports on the Work Plan, as well as the status of the convergence project, beginning no later than October 2010 and frequently thereafter until the work is complete.<sup>9</sup> The SEC intends to make a decision on whether to incorporate IFRS into the U.S. financial reporting system by 2011. According to the press release, the transition would not occur until 2015 at the earliest.<sup>10</sup>

## SEC Sets New Short Sale Price Test (Amendment of Regulation SHO)

On February 24, the SEC adopted a new rule to place certain restrictions on short selling when a stock is experiencing significant downward price pressure.<sup>11</sup> According to the press release, “[t]he measure is intended to promote market stability and preserve investor confidence.”

This alternative uptick rule, Rule 201, seeks to restrict short selling from further driving down the price of a stock that has triggered a circuit breaker by dropping more than 10% in one day. Once the circuit breaker is triggered, this restriction seeks to accomplish its objective by enabling long sellers to sell their shares before any short sellers.

Other features of the alternative uptick rule include:

- *Duration Restriction:* Once the circuit breaker has been triggered, the rule would apply to short sale orders in that security for the remainder of the day as well as the following day.
- *Securities Coverage:* The rule generally applies to all equity securities that are listed on a national securities exchange, whether traded on an exchange or in the over-the-counter market.
- *Implementation:* The rule requires trading centers to establish, maintain, and enforce written policies and procedures that are rea-

sonably designed to prevent the execution or display of a prohibited short sale.

The rule will become effective May 10, 2010. Market participants will have six months to comply with the requirements.

## SEC Adopts Money Market Reform Rules

On January 27, the SEC adopted new rules seeking to strengthen the regulatory requirements governing money market funds and to better protect investors.<sup>12</sup> The new rules are intended to increase the resilience of money market funds to economic stresses and to reduce the risks of runs on the funds by tightening the maturity and credit quality standards and imposing new liquidity requirements.

The new rules can be divided into three broad categories: those that (a) impose further restrictions on money market fund risks; (b) enhance disclosure of portfolio securities; and (c) improve money market fund operations.

### Further Restricting Risks by Money Market Funds

- *Improved Liquidity*—The new rules require money market funds to have a minimum percentage of their assets in highly liquid securities so that those assets can be readily converted to cash to pay redeeming shareholders. Currently, there are no minimum liquidity mandates.
  - *Daily Requirement:* For all taxable money market funds, at least 10% of assets must be in cash, U.S. Treasury securities, or securities that convert into cash (e.g., mature) within one day.
  - *Weekly Requirement:* For all money market funds, at least 30% of assets must be in cash, U.S. Treasury securities, certain other government securities with remaining maturities of 60 days or less, or securities that convert into cash within one week.

The rules would further restrict the ability of money market funds to purchase illiquid securities by:

- Restricting money market funds from purchasing illiquid securities if, after the purchase, more than 5% of the fund's portfolio will be illiquid securities (rather than the current limit of 10%).
- Redefining as "illiquid" any security that cannot be sold or disposed of within seven days at carrying value.
- *Higher Credit Quality*—The new rules place new limits on a money market fund's ability to acquire lower quality (Second Tier) securities. They do this by:
  - Restricting a fund from investing more than 3% of its assets in Second Tier securities (rather than the current limit of 5%).
  - Restricting a fund from investing more than one-half of 1% (or, 0.5%) of its assets in Second Tier securities issued by any single issuer (rather than the current limit of the greater of 1% or \$1 million).
  - Restricting a fund from buying Second Tier securities that mature in more than 45 days (rather than the current limit of 397 days).
- *Shorter Maturity Limits*—The new rules shorten the average maturity limits for money market funds, which seeks to limit the exposure of funds to certain risks such as sudden interest rate movements. They do this by:
  - Restricting the maximum "weighted average life" maturity of a fund's portfolio to 120 days. Currently, there is no such limit. The effect of the restriction is to limit the ability of the fund to invest in long-term floating rate securities.
  - Restricting the maximum weighted average maturity of a fund's portfolio to 60 days. The current limit is 90 days.
- *"Know Your Investor" Procedures*—The new rules require funds to hold sufficiently liquid securities to meet foreseeable redemptions. Currently, there are no such requirements. In order to meet this new requirement,

funds would need to develop procedures to identify investors whose redemption requests may pose risks for funds. As part of these procedures, funds would need to anticipate the likelihood of large redemptions.

- *Periodic Stress Tests*—The new rules require fund managers to examine the fund's ability to maintain a stable net asset value per share in the event of shocks—such as interest rate changes, higher redemptions, and changes in credit quality of the portfolio. Previously, there were no stress test requirements.
- *Nationally Recognized Statistical Rating Organizations (NRSROs)*—The new rules continue to limit a money market fund's investment in rated securities to those securities rated in the top two rating categories (or unrated securities of comparable quality). At the same time, the new rules also continue to require money market funds to perform an independent credit analysis of every security purchased. As such, the credit rating serves as a screen on credit quality, but can never be the sole factor in determining whether a security is appropriate for a money market fund.

In addition, the new rules improve the way that funds evaluate securities ratings provided by NRSROs:

- Require funds to designate each year at least four NRSROs whose ratings the fund's board considers to be reliable. This permits a fund to disregard ratings by NRSROs that the fund has not designated, for purposes of satisfying the minimum rating requirements, while promoting competition among NRSROs.
- Eliminate the current requirement that funds invest only in those asset backed securities that have been rated by an NRSRO.
- *Repurchase Agreements*—The new rules strengthen the requirements for allowing a money market fund to "look through" the repurchase issuer to the underlying collateral securities for diversification purposes:

- Collateral must be cash items or government securities (as opposed to the current requirement of highly rated securities).
- The fund must evaluate the creditworthiness of the repurchase counterparty.

## Enhancing Disclosure of Portfolio Securities

- *Monthly Web Site Posting*—The new rules require money market funds each month to post on their Web sites their portfolio holdings. Currently, there is no Web site posting requirement. Portfolio information must be maintained on the fund's Web site for no less than six months after posting.
- *Monthly Reporting*—The new rules also require money market funds each month to report to the Commission detailed portfolio schedules in a format that can be used to create an interactive database through which the Commission can better oversee the activities of money market funds. The information reported to the Commission would be available to the public 60 days later. This information would include a money market fund's "shadow" net asset value (NAV), or the mark-to-market value of the fund's net assets, rather than the stable \$1.00 NAV at which shareholder transactions occur. Currently a money market fund's "shadow" NAV is reported twice a year with a 60-day lag.

## Improving Money Market Fund Operations

- *Processing of Transactions*—The new rules require money market funds and their administrators to be able to process purchases and redemptions electronically at a price other than \$1.00 per share. This requirement facilitates share redemptions if a fund were to break the buck.
- *Suspension of Redemptions*—The new rules permit a money market fund's board of di-

rectors to suspend redemptions if the fund is about to break the buck and decides to liquidate the fund (currently the board must request an order from the SEC to suspend redemptions). In the event of a threatened run on the fund, this allows for an orderly liquidation of the portfolio. The fund is now required to notify the Commission prior to relying on this rule.

- *Purchases by Affiliates*—The new rules expand the ability of affiliates of money market funds to purchase distressed assets from funds in order to protect a fund from losses. Currently, an affiliate cannot purchase securities from the fund before a ratings downgrade or a default of the securities—unless it receives individual approval. The rule change permits such purchases without the need for approval under conditions that protect the fund from transactions that disadvantage the fund. The fund must notify the Commission when it relies on this rule.

The new rules are effective May 5, 2010. Mandatory compliance with some of the rules will be phased in during the year.

### NOTES

1. SEC Release Nos. 33-9108; 34-61560 (Feb. 22, 2010) available at: <http://www.sec.gov/rules/final/2010/33-9108.pdf>.
2. SEC Release Nos. 33-9108; 34-61560.
3. SEC Release Nos. 33-9108; 34-61560.
4. SEC Release Nos. 33-9108; 34-61560.
5. SEC Release Nos. 33-9108; 34-61560.
6. SEC Release No. 2010-27 available at: <http://www.sec.gov/news/press/2010/2010-27.htm>.
7. SEC Votes on Work Plan for Incorporation IFRS by Michael Cohn, Feb. 24, 2010 available at: <http://www.webcpa.com/news/SEC-Votes-Work-Plan-Incorporating-IFRS-53368-1.html>.
8. SEC Release No. 2010-27.
9. SEC Release No. 2010-27.
10. SEC Release No. 2010-27.
11. SEC Press Rel. No. 2010-26, Feb. 24, 2010, available at <http://www.sec.gov/news/press/2010/2010-26.htm>. See also SEC Rel. No. 34-61595, Feb. 26, 2010, available at <http://www.sec.gov/rules/final/2010/34-61595.pdf>.
12. SEC Press Rel. No. 2010-14, Jan. 27, 2010, available at <http://www.sec.gov/news/press/2010/2010-14.htm>. See also SEC Rel. No. IC-29132, Feb. 23, 2010, available at <http://www.sec.gov/rules/final/2010/ic-29132.pdf>.

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