
Securities Law Developments

SEC PROPOSES RULE AMENDMENTS TO MANDATE EDGAR FILING FOR FOREIGN ISSUERS AND IMPLEMENT CUSTOMER PROTECTION AND MARGIN RULES FOR SECURITY FUTURES

Chairman Harvey Pitt presided over his first open meeting of the Securities and Exchange Commission (“Commission” or “SEC”) on September 25, 2001. During the course of that meeting, the Commission issued rule proposals to mandate EDGAR filing for foreign issuers and to implement customer protection and margin rules for security futures. The Commission also extended the compliance date of several rule amendments and extended the deadline for comment on two proposed rule amendments and a concept release.

Proposed Rules to Mandate EDGAR Filing for Foreign Issuers

The Commission proposed rule amendments to require foreign private issuers and foreign governments to file their Securities Act of 1933 (“Securities Act”) and Securities Exchange Act of 1934 (“Exchange Act”) documents electronically through the Commission’s Electronic Data Gathering, Analysis and Retrieval (“EDGAR”) System.¹ The proposal would amend Regulation S-T, the Commission’s rules governing electronic filing, to eliminate the foreign issuer exception from mandated EDGAR filing for most Securities Act and Exchange Act documents. The proposal also would eliminate the option for foreign issuers to provide an English-language summary of certain documents and instead require an English-language translation of the entire document.

Pitt directed the staff to coordinate with foreign regulators to solicit comments from issuers that would be affected by the proposed rules. He expressed concern that the burden of electronic filing not dissuade foreign issuers from using the U.S. capital markets. In response to questions from

¹ *Mandated EDGAR Filing for Foreign Issuers*, Securities Act Release No. 8016; Exchange Act Release No. 44868; International Series Release No. 1250 (Sept. 28, 2001), available at <http://www.sec.gov/rules/proposed/33-8016.htm>. “Foreign private issuer” is defined in Securities Act Rule 405. “Foreign government” refers to any issuer that is eligible to register securities under Schedule B of the Securities Act, including political subdivisions and some quasi-governmental entities.

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Commissioner Unger, the staff confirmed that it did not plan to expand EDGAR's hours of operation to accommodate electronic filing by foreign issuers during their business hours. Pitt directed the staff to prepare a cost estimate to operate the EDGAR system 24 hours a day, seven days a week. Pitt also directed the staff to provide a cost estimate to make EDGAR filings immediately available on the Commission's website. Comments on the proposal are due by December 3, 2001.

If you have any questions regarding this proposal, please call Meredith Cross (202-663-6644) or Lori Price (202-663-6329).

Proposed Customer Margin Rules Relating to Security Futures

The Commission proposed rules governing the collection of customer margin for security futures. The rules were developed jointly with the Commodity Futures Trading Commission ("CFTC").² The Commodity Futures Modernization Act of 2000 ("CFMA") lifted the ban on trading in security futures and related products and established a framework for joint regulation of these products by the Commission and the CFTC. This rule proposal is the latest in a series of jointly developed regulatory initiatives to implement the provisions of the CFMA.

The CFMA authorized the Board of Governors of the Federal Reserve System ("Board") to prescribe customer margin requirements for security futures products. The Board delegated this authority jointly to the Commission and the CFTC. The proposed rules would apply to margin agreements between brokers, dealers, and members of national securities exchanges and their customers regarding security futures. Among other things, the proposed rules would:

- require each party to a security future contract to provide and maintain, on a daily basis, margin equal to 20 percent of the current market value of the security future contract;
- permit regulatory authorities to reduce the margin levels for risk-reducing offset positions involving security futures, consistent with comparable offset positions involving exchange-traded options;
- require firms to collect initial and maintenance margin from their customers within three business days;³ and
- permit customers to satisfy margin requirements under the proposed rules using the same type of collateral permitted under Regulation T.

The following would be excluded from the proposed rules: (a) margin arrangements that comply with a portfolio margining system established under the rules of a national securities exchange or association that have been approved by the Commission; (b) financial relations between a foreign branch of a creditor and a foreign person involving foreign securities; (c) additional margin

² *Customer Margin Rules Relating To Security Futures*, Exchange Act Release No. 44853 (Sept. 26, 2001), available at <http://www.sec.gov/rules/proposed/34-44853.htm>.

³ The comparable Regulation T requirement is five business days. The release indicates that the shorter time period is intended to lower counterparty risk.

requirements imposed by registered clearing agencies on their members; and (d) margin arrangements between a creditor and a borrower that is an “exempted borrower” under Regulation T, as well as certain market makers in securities futures. Comments on the proposal are due by November 5, 2001.

If you have any questions regarding this proposal, please call Brandon Becker (202-663-6979), Mark Shelton (202-663-6277), or Lori Price (202-663-6329).

Applicability of CFTC and SEC Customer Protection Rules to Security Futures Accounts

Pursuant to the CFMA, the Commission, jointly with the CFTC, proposed rules as part of the process of establishing a joint regulatory framework for persons registered with the CFTC as a futures commission merchant and registered with the Commission as a broker or dealer to effect transactions in security futures products for customers.⁴ The CFMA directs the Commission and the CFTC to issue rules to avoid duplicative or conflicting regulations applicable to firms doing business in security futures products that are fully-registered with both the Commission and the CFTC.

A firm fully-registered with both the Commission and the CFTC would be able to choose, or allow its customers to choose, whether to hold security futures products in a futures account subject to the segregation requirements of the Commodity Exchange Act or in a securities account subject to Exchange Act Rule 15c3-3 and the Securities Investor Protection Act of 1970 (“SIPA”). Before accepting an order for a security futures product, the firm would be required to furnish customers with a disclosure document that describes the SEC/SIPA and the CFTC customer protection frameworks, and a statement regarding which framework would and which would not be applicable to the customer’s account. The firm would be required to obtain a signed acknowledgment from the customer stating that the customer understands that the account will not be protected under the alternative customer protection framework. While the proposed rules do not prescribe specific language for the disclosure document, the release indicates that industry representatives are developing a model disclosure document.

The Commission considered this proposal together with the proposed customer margin rules for security futures described above. Pitt directed the staff to take a more interactive approach to the comment process for these proposed rules. He suggested that the staff consider conducting, jointly with the CFTC, “town hall meetings” to facilitate the comment process and engage in a dialogue with industry representatives. Pitt urged the staff to consider other ways to facilitate implementation of these proposals. Comments on the proposal are due by November 5, 2001.

If you have any questions regarding this proposal, please call Brandon Becker (202-663-6979), Mark Shelton (202-663-6277), or Lori Price (202-663-6329).

⁴ *Applicability of CFTC and SEC Customer Protection, Recordkeeping, Reporting, and Bankruptcy Rules and the Securities Investor Protection Act of 1970 to Accounts Holding Security Futures Products*, Exchange Act Release No. 44854 (Sept. 26, 2001), available at <http://www.sec.gov/rules/proposed/34-44854.htm>.

Extension of Compliance Date for Rules on Mutual Fund After-Tax Return Information

The Commission extended the compliance date from October 1 to December 1, 2001, for rule amendments requiring fund advertisements and sales literature to include standardized after-tax returns.⁵ The amendments require inclusion of standardized after-tax returns if the sales material either (i) includes after-tax performance information; or (ii) includes any performance information and also represents that the fund is managed to limit taxes. Representatives of four major fund groups requested an extension of the compliance date to request clarification from the staff regarding calculation of the after-tax returns required by the rule amendments. The fund groups indicated that they only recently became aware of a lack of agreement within the fund industry, as well as third-party providers, on several components of the after-tax return calculation. The fund groups indicated that the October 1, 2001 compliance date would be particularly problematic for fund supermarkets that rely on third-party providers for the after-tax returns for non-proprietary funds published on the supermarket websites.

If you have any questions regarding this extension, please call Marianne Smythe (202-663-6711), James Anderson (202-663-6180), or Lori Price (202-663-6329).

Extension of Compliance Date for Trade-Through Disclosure Rule

The Commission extended the compliance date of Exchange Act Rule 11Ac1-7 from October 1, 2001 to April 1, 2002.⁶ The rule requires a broker-dealer to disclose to its customer when the customer's order for listed options is executed at a price inferior to a better published quote, and to disclose the better published quote available at that time. A broker-dealer is not required to provide this disclosure to its customer if the broker-dealer effects the transaction on an exchange that participates in an approved linkage plan that includes provisions reasonably designed to limit customers' orders from being executed at prices that trade through a better published price. While the staff recommended extending the compliance date for nine months, the Commission extended the compliance date for six months. Pitt directed the staff to establish a dialogue with industry representatives to assess the industry's progress in establishing linkage plans.

If you have any questions regarding this extension, please call Brandon Becker (202-663-6979), Mark Shelton (202-663-6277), or Lori Price (202-663-6329).

Extension of Deadline to Submit Rule Filings Regarding Decimal Pricing

The Commission extended the deadline from November 5, 2001 to January 14, 2002, for the exchanges and the National Association of Securities Dealers to submit rule filings to establish the

⁵ *Disclosure of Mutual Fund After-Tax Returns; Extension of Compliance Date*, Securities Act Release No. 8010; Exchange Act Release No. 44850; Investment Company Act Release No. 25175 (Sept. 26, 2001), available at <http://www.sec.gov/rules/final/33-8010.htm>. The compliance date for the amendments to Form N-1A, which were adopted by the Commission at the same time as the rule amendments, remains February 15, 2002. See *Disclosure of Mutual Fund After-Tax Returns*, Exchange Act Release No. 7941 (Jan. 18, 2001).

⁶ *Firm Quote and Trade-Through Disclosure Rule for Options*, Exchange Act Release No. 44852 (Sept. 26, 2001), available at <http://www.sec.gov/rules/final/34-44852.htm>.

minimum price variation in each market for quoting equity securities and options, and to submit studies regarding the impact of decimal pricing on systems capacity, liquidity and trading behavior, including an analysis of whether there should be a uniform price increment for securities.⁷ The extension was granted in view of the market disruption caused by the attacks of September 11, 2001. In response to Commissioner Unger's question, the staff indicated that the anti-trust protection of the initial Commission order also would be extended.

If you have any questions regarding this extension, please call Brandon Becker (202-663-6979), Mark Shelton (202-663-6277), or Lori Price (202-663-6329).

Comment Period Extended for Concept Release on Effects of Decimal Trading in Subpennies

The Commission extended the comment period from September 24 to November 23, 2001, for the Concept Release on the Effects of Decimal Trading in Subpennies.⁸ The Concept Release solicited comment on the impact of subpenny price increments for quotations, orders, and trading stocks in a decimals environment, particularly the effects on subpenny trading on market transparency, customer protection rules, and automated systems. The extension was granted in response to requests from various market participants as well as the market disruptions caused by the attacks of September 11, 2001. Commissioner Hunt encouraged the electronic communications networks to comment on the Concept Release.

If you have any questions regarding this extension, please call Brandon Becker (202-663-6979), Mark Shelton (202-663-6277), or Lori Price (202-663-6329).

⁷ *Order Extending the Deadline for the American Stock Exchange LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the Chicago Stock Exchange, Inc., the Cincinnati Stock Exchange, the International Securities Exchange, LLC, the National Association of Securities Dealers, Inc., the New York Stock Exchange, Inc., the Pacific Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc., to Submit Rule Filings Concerning the Implementation of Decimal Pricing in Equity Securities and Options Pursuant to Section 11A(a)(3)(B) of the Securities Exchange Act of 1934*, Exchange Act Release No. 44846 (Sept. 25, 2001), available at <http://www.sec.gov/rules/other/34-44846>.

⁸ *Request for Comment on the Effects of Decimal Trading in Subpennies; Extension of Comment Period*, Exchange Act Release No. 44845 (Sept. 25, 2001), available at <http://www.sec.gov/rules/concept/34-44845.htm>.

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