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Securities Law News

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A FREE LUNCH CAN BE EXPENSIVE

SEC ACTS TO PROTECT OLDER INVESTORS

In May 2006, the SEC and the North American Securities Administrators Association announced a coordinated national initiative designed to protect seniors from investment fraud and sales of unsuitable securities.

In late August of this year, the Commission filed an emergency court action in Sacramento, California, to shut down a \$25 million Ponzi scheme that victimized hundreds of senior and other investors nationwide who bought fractional ownership interests in life insurance policies. In its release reporting this action, the Commission reported that it has brought more than 40 enforcement actions over the past two years against frauds targeting retirees and older investors.

In early September the Commission announced settlements with two Massachusetts securities firms and an individual for failing to supervise a registered representative who engaged in a multi-million dollar fraud. At least



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Meet the Author

Articles in this issue of *Securities Law News* were written by Oliver Janney, a managing attorney at Robbins Equitas™. His areas of practice include mergers and acquisitions, aviation and corporate law.

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SEC CLARIFIES SHAREHOLDER PROPOSAL RULE ON EVE OF PROXY SEASON

On December 6, 2007, the SEC issued a final rule designed to dispel the uncertainty about shareholder proposals that marked the past proxy season. The confusion arose from a decision by the Second Circuit Court of Appeals that refused to give effect to recent interpretations by the SEC and

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SEC TIGHTENS REGULATION OF DEFERRED VARIABLE ANNUITIES

The SEC recently approved proposed new NASD Rule 2821 relating to the sales practice standards and supervisory and training requirements applicable to transactions in deferred annuities. This action came in response to findings by the NASD of numerous instances of questionable sales practices in connection with the purchase or exchange of deferred variable annuities, including unsuitable recommendations and omissions and misrepresentations. The new rule creates supervisory requirements, recommendation requirements and principal review and approval requirements tailored specifically to transactions in deferred variable annuities. This rule supplements existing rules and procedures, and applies to the purchase/exchange of a deferred variable annuity and to an investor's initial subaccount allocations.

The rule has four requirements:

1. A securities firm must have a reasonable basis to believe that the transaction is suitable for the customer and be able to demonstrate that the customer has been informed of various features of deferred variable annuities, that the customer would benefit from various features of the product and that the particular annuity and the underlying subaccounts are suitable for the customer. A registered representative must consider several specific factors before recommending exchange of a deferred variable annuity.
2. A registered principal must review and indicate approval or lack of approval within 7 business days after the customer signs the application. The registered principal must have a reasonable basis to believe that the transaction would be suitable.
3. Member firms must develop and maintain supervisory procedures that are reasonably designed to achieve compliance with the rule, including surveillance procedures and policies and procedures reasonably designed to implement corrective measures to address inappropriate exchanges and the conduct of associated persons who engage in inappropriate exchanges.
4. Members must develop and implement training programs that are tailored to educate registered representatives and registered principals on the material features of deferred variable annuities and the requirements of the rule.

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its staff of a position taken in 1976.

Rule 14a-8 provides shareholders that have continuously held at least \$2,000 in market value or 1% of the company's voting securities for 12 months with an opportunity to include certain proposals in a company's proxy statement. Under Rule 14a-8 a company does not have to include in its proxy statement a shareholder proposal that "relates to an election for membership on the company's board of directors or analogous governing body." In recent years the Commission staff had taken the position that this provision relates both to a specific election and the process for election.

Last year the Second Circuit Court of Appeals in *American Federation of State, County & Municipal Employees, Employees Pension Plan v. American International Group, Inc.* ruled that AIG could not rely on the rule to exclude a shareholder proposal seeking to amend the company's bylaws to establish a procedure under which the company would be required in certain circumstances to include shareholder nominees for director in the company's proxy statement. Then during the 2007 proxy season, the staff of the Commission refused to take any position on the exclusion of such shareholder proposals.

Trumpeting its "fundamental responsibility to make sure that the rules and regulations it adopts have clear meaning," the Commission codified the staff's longstanding interpretation of the rule, which now permits exclusion of a shareholder proposal "[i]f the proposal relates to a nomination or an election for membership on the company's board of directors or analogous governing body or a procedure for such nomination or election." The excluded proposals can still be raised by contest under the Commission's proxy rules.

SEC EASES RESTRICTIONS ON RAISING CAPITAL

This month the SEC has announced several actions that are designed to make it easier and speedier for smaller companies to raise capital.

On December 6th, the SEC issued revisions to Rule 144 to make it easier for persons who are not affiliated with the issuer to sell restricted securities, which are unregistered securities acquired from the issuing company. The revisions will be effective 60 days after their publication in *The Federal Register*.

Rule 144 provides a safe harbor from the definition of “underwriter” as used in Section 4(1) of the Securities Act of 1933. Section 4(1) provides an exemption for registration of securities transactions by any person other than an issuer, an underwriter or dealer. Rule 144 regulates the resale of two categories of securities – restricted securities and control securities. The recent release focuses on restricted securities. The rule includes both equity (i.e., stock) and debt securities.

The revision will relax the conditions for use of Rule 144 for sale of restricted securities. The conditions that were relaxed include the holding period, the specified sales volume limitations, and manner of sale requirements and the threshold for filing Form 144 in connection with a sale.

The new requirements for sale by non-affiliates of restricted securities in the wake of these revisions can be summarized as follows:

- No resales may be made under Rule 144 during the six-month holding period.
- During the seventh through twelfth months after acquisition, the holder may make unlimited public resales; however the public information requirement still applies. If the issuer has not been a reporting company under the Securities Exchange Act for the 90 days prior to the sale, the stock cannot be sold until a full year from the acquisition of the securities has elapsed.
- After the one-year holding period, there are no further restrictions on the securities.

The release indicates that Rule 144 may not be used for sale of securities of shell companies - companies that have no business and insignificant assets or only cash and cash equivalents. On December 11th, the SEC announced that it had approved extension of the availability of Form S-3 to smaller issuers, in order to “give smaller companies faster and easier access to capital when they need it or market conditions are favorable.”

The change, which will be effective 30 days after publication in *The Federal Register*, will enable smaller companies to file simplified registration statements for their securities and incorporate by reference their filings under the Securities Exchange Act. Currently, use of the form is restricted to companies with a public float of \$75 million.

Companies will have to comply with the following requirements in order to use Form S-3 once the change is effective:

- Meet the other eligibility requirements of the Form
- Not be shell companies for at least 12 months prior to filing the registration statement.
- Have a class of common equity securities listed and registered on a national exchange.
- Not sell more than the equivalent of more than 1/3 of their public float in primary offerings under the new instructions in any period of 12 calendar months.

The exclusion of shell companies from both of these easing of requirements reflects discomfort on the part of the SEC with such companies, which it defines as a registrant (other than an asset-based issuer) that has (1) no or nominal operations and (2) either (a) no or nominal assets, (b) assets consisting solely of cash and cash equivalents or (c) assets consisting of any amount of cash and cash equivalents and nominal other assets.

Once the SEC issues its formal release on the second change, more details should be available.



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40 of the victims of the fraud were over age 70. The penalties included \$250,000 fines levied against the two firms and a \$50,000 fine against the individual. Earlier, the two firms and a third had paid a combined total of more than \$6 million to victims of the fraud.

Then on September 10th, the SEC held its second annual Seniors Summit in Washington, D.C. At that summit the Commission released the findings from regulatory examinations of 110 firms offering “free lunch” investment seminars aimed at seniors. Half of the examinations found claims that might have been misleading or exaggerated or unwarranted. The examinations found poor supervision over many of the seminars and in some instances fraud. Many of the firms did not have specific policies and procedures for the sales seminars. The firms frequently had not submitted the sales materials to the NASD’s Department of

Advertising Regulation as required. In many instances long-term or particularly risky investments such as variable annuities and real estate investment trusts and collateralized mortgage obligations were marketed to seniors for whom they are not likely to be suitable investments.

The message of these actions is that the SEC is particularly watchful over the interests of senior investors, and securities firms should accordingly be sensitive to these regulatory concerns.

As stated by FINRA CEO Mary Shapiro at the Seniors Summit,

“With almost 8 out of 10 seniors being targeted with these tactics, the findings underscore a true need for increased educational and enforcement efforts... We need to send a clear message right now that high pressure sales activity is simply unacceptable.”



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