

CCSB Bail-Out Bulletin No. 1

Those who thought they were waiting only for the final form of the proposed massive government intervention in U.S. financial markets received a shock Monday as the House rejected the compromise measure that many had expected (well, hoped) would restore some stability and confidence to those markets. Partisan bickering erupted immediately upon the proposal's failure, even as leaders vowed to back up and try again to bring a revised plan to a vote later this week. Meanwhile, as most were following the twists and turns of the "big story" on the bail-out, a number of other significant developments emerged, summarized below (often with links to more comprehensive descriptions):

New Rules on Short Selling and on Financial Stocks and Derivatives

Short sale rules. On September 17, two days before it announced a ban on the short selling of 799 financial stocks, the SEC promulgated three new rules designed to prevent naked short selling. The first imposes enhanced requirements for delivering securities pursuant to a short sale, as well as penalties on short sellers and broker-dealers who fail to deliver securities within the three-day settlement period. The second rule bans naked short selling by options market makers. The third makes clear that it is a violation of Rule 10b-5 when a short seller misrepresents its intention or ability to deliver securities on or before the settlement date, and the short seller in fact fails to deliver the securities prior to the settlement date.

- SEC Press Release Summarizing New Rules
<http://www.sec.gov/news/press/2008/2008-204.htm>
- New Rules
<http://www.sec.gov/rules/other/2008/34-58572.pdf>

Temporary short sale ban. On September 19, the SEC promulgated an emergency order prohibiting the short-selling of securities of 799 financial companies. The order expires on October 2, 2008, but the SEC has said it may extend it. Recently, the SEC delegated authority to the NYSE and NASDAQ to determine whether *other* companies should be protected from short selling. As of Friday, September 26, the list of companies whose securities are subject to the short sale ban was approaching 1000 due to additions by both exchanges. The SEC also announced two other temporary rules, the first requiring institutional money managers to report their new short sales of securities on a weekly basis, and the second temporarily enhancing the ability of issuers to repurchase their own shares (and thus provide liquidity to the market).

- SEC Press Release
<http://www.sec.gov/news/press/2008/2008-211.htm>
- Order Banning Short Selling
<http://www.sec.gov/rules/other/2008/34-58592.pdf>
- NYSE Short Sale List
http://www.nyse.com/about/listed/1222078675703.html?sa_campaign=/internal_ads/ticker/09222008seclist

- NASDAQ Short Sale List
http://www.nasdaqtrader.com/Trader.aspx?id=trader_sec_shortsale
- Order Requiring Money Managers to Report Short Selling
<http://www.sec.gov/rules/other/2008/34-58591.pdf>
- Amended Order Requiring Money Managers to Report Short Selling
<http://www.sec.gov/news/press/2008/2008-217.htm>
- Order Easing Restrictions on Issuer's Ability to Repurchase Shares
<http://www.sec.gov/rules/other/2008/34-58588.pdf>

Fed relaxes restrictions. In an effort to encourage investment in American banks, the Federal Reserve removed some restrictions that have limited activities of the banks' investors. According to *The Wall Street Journal*, "[t]he Fed showed flexibility in three main areas: allowing certain investors to hold board seats, communicate with bank management, and own larger amounts of stock."

- More information about the rule changes is available at:
<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20080922b1.pdf>

NY credit-default swap regulation. The New York Insurance Department issued new guidelines that characterize some credit-default swaps as "insurance and therefore subject to state regulation."

- More information about the rules, to become effective in January of next year, is available at:
<http://www.nytimes.com/2008/09/23/business/23swap.html?ref=business>; and at
<http://www.ins.state.ny.us/press/2008/p0809224.pdf>

Increased Investigations by the SEC and Others

SEC market manipulation investigation. Also on September 19, the SEC announced that it was expanding its ongoing investigation into market manipulation. Specifically, the SEC announced that it will require hedge fund managers, broker-dealers, and institutional investors who have "significant trading activity" in financial companies or positions in credit default swaps to report their positions under oath. The SEC also approved a formal order of investigation, which allows its staff to subpoena documents and testimony. Finally, the SEC announced that it would be coordinating its investigation with the NYSE and FINRA, and that those entities would be making on-site visits to various broker-dealers to address concerns about short-selling activity.

- SEC Press Release
<http://www.sec.gov/news/press/2008/2008-214.htm>

FBI probe. The FBI has launched probes into whether fraud contributed to the downfall of Fannie Mae, Freddie Mac, Lehman Bros., and AIG. The companies have declined to comment on the investigations.

SEC inquiry. The SEC has asked more than two dozen hedge funds for trading information and e-mails related to AIG, Goldman Sachs, Lehman Bros., Morgan Stanley, Washington Mutual and Merrill Lynch. The Wall Street Journal described the investigations as "part of an effort to crack down on

rumor mongering and abusive short selling, which some believe contributed to the collapse of Bear Stearns.” The SEC also reportedly is investigating Fannie Mae. Both Fannie Mae and Freddie Mac are already under fire from the United States Attorney’s office for the Southern District of New York.

CFTC looks at silver. Spurred on by disappointed investors in silver, the CFTC has begun investigating manipulation in the commodity by banks. While gold has increased 6.5% this year, silver is down 9.5%.

Public and Private “Bail-Outs” Apart from “the Big One”

AIG. AIG failed to find private financing and signed a “definitive agreement” to borrow up to \$85 billion from the Federal Reserve. Under the plan, the Fed will acquire an almost 80% interest in the insurer. Citing the risk that delay could “seriously jeopardize the financial viability” of the insurer, AIG acted without a shareholder vote.

- <http://phx.corporate-ir.net/phoenix.zhtml?c=76115&p=irol-newsArticle&ID=1200447&highlight=>

Fed reaches out to other central banks. The Federal Reserve announced on September 29 that it is working with other central banks “to support financial stability and to maintain a stable flow of credit to the economy during this period of significant strain in global markets.” Efforts include making an additional \$330 billion available through reciprocal currency swap arrangements.

- <http://www.federalreserve.gov/newsevents/press/monetary/20080929a.htm>

WaMu. Washington Mutual collapsed on September 28 after suffering massive losses and failing to find a private equity buyer. The FDIC, which was appointed the thrift’s receiver, sold WaMu’s banking operations to J.P. Morgan for \$1.9 billion. Washington Mutual’s failure will not immediately affect its depositors, but according to *The Wall Street Journal*, “holders of more than \$30 billion in debt and preferred stock will likely see little if any recovery.”

- http://topics.nytimes.com/top/news/business/companies/washington_mutual_inc/index.html?inline=nyt-org

Wachovia. According to *The Wall Street Journal*, Citigroup has acquired most of Wachovia’s operations. Under the approximately \$2 billion dollar deal, Citigroup will assume many of Wachovia’s troubled mortgages, but the government will absorb any losses in excess of \$42 billion in exchange for \$12 billion of warrants on Citigroup stock. Wachovia depositors will be unaffected by the sale, which was engineered by the FDIC, Treasury Department and Federal Reserve.

- http://money.cnn.com/2008/09/29/news/companies/wachovia_citigroup/index.htm?cnn=yes

Sharing the Pain: Troubles Abroad

Britain. The British government has announced plans to nationalize mortgage lender Bradford & Bingley (B&B). B&B is the second UK bank nationalized this year; the government nationalized Northern Rock in February.

Continental Europe. The Central Banks of the Netherlands, Belgium, and Luxembourg have agreed to infuse \$16.1 billion into Belgium-Dutch bank Fortis in an effort to save the bank. According to the BBC, “Fortis was seen as too big a European bank to be allowed to go under.” In addition, Belgium, France, and Luxembourg have announced plans to inject approximately \$9 billion in Dexia SA, a Belgian-French financial institution with broad exposure to the U.S. housing market.

Iceland. Iceland has taken the helm of the country’s third-largest bank, Glitnir.

- http://news.bbc.co.uk/2/hi/in_depth/business/2007/creditrunch/default.stm

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