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SEC FINALIZES RULES ON OWNERSHIP REPORTS AND TRADING BY OFFICERS, DIRECTORS AND PRINCIPAL SECURITY HOLDERS

Summary

On August 27, 2002, the Securities and Exchange Commission adopted rule and form amendments regarding the accelerated filing of ownership reports by officers, directors and principal security holders under Section 16(a) of the Securities Exchange Act of 1934.¹ These amendments are adopted as mandated by the recently enacted Sarbanes-Oxley Act of 2002.²

Background

As summarized in our April letter,³ the SEC, in response to investor fervor and a demand for faster, more detailed disclosure, recommended a new Form 8-K disclosure. The proposal required public companies to report significant management transactions (i.e., transactions in company equity securities including derivatives, Rule 10b5-1 arrangements and loans) within an accelerated time period. The comment period for the proposed rule expired June 24, 2002. During this same time period, Congress was aggressively working on legislation to address corporate governance issues in an effort to suppress mounting public skepticism of corporate financial statements.

On July 30, 2002, the Sarbanes-Oxley Act of 2002 was enacted. Part of the new legislation addressed issues that were covered under the SEC's April proposal. Specifically, Section 403(a) of the Act amended Section 16(a) to require insiders to report ownership changes, including the purchase or sale of a security-based swap agreement, by the end of the second business day following the date of the transaction. Thus, instead of an expanded disclosure under Form 8-K as proposed by the SEC, the disclosure will appear under Section 16(a) on amended Forms 4 and 5. The effective date for the new filing deadline is August 29, 2002.

Rule and Form Amendments

In order to conform with the Sarbanes-Oxley Act of 2002, the SEC has made the following rule and form changes under Section 16(a):

- Amended Section 16(a) forms to conform with the new two-business day statutory filing deadline and made clear that Form 4 is no longer a monthly form

¹ See SEC release No. 34-4642; <http://www.sec.gov/rules/final/34-46421.htm>

² See our alert letter, "Executive Compensation Implications of Sarbanes-Oxley Act of 2002," August 9, 2002.

³ "SEC Proposals Accelerate Periodic Report Filing Dates and Highlight Certain Management Transactions," April 23, 2002.

- In the “holdings” column on the form, reporting persons must indicate their current holdings following the reported transaction(s). This differs from prior reporting which required only month-end holdings disclosure
- New columns will be added to the forms to require reporting of deemed execution dates for the two exemptions under Rule 16(a)-3(g) as discussed in more detail below
- The new two-business day period begins running on the execution/transaction date

The following is an example of how the new deadline works:

- If a transaction is executed any time on Tuesday, September 3, the Form 4 will be due by the close of business (5:30pm EST) at the Commission on Thursday, September 5
- Although not presently available, the SEC plans to publish as expeditiously as possible forms incorporating the new amendments
 - The release gives guidance on how to modify the current forms to comply with the new rules until the new forms are available
- Amended Rules 16a-3(f) and 16a-6(a) to require that all transactions which are exempt from Section 16(b) short-swing profit recovery be reportable within two business days on the Form 4
 - These transactions had been reportable on an annual basis on Form 5 which is due within 45 days after the issuer’s fiscal year end
 - All other transactions previously reportable on Form 5 remain so
 - With these amendments, Form 4 will now encompass derivative securities transactions involving issuances, exercises, and cancellations and regrants of stock options, including repricings
- Amended Rule 16a-3(g) to allow for two narrowly defined exceptions to the two-business day Form 4 filing deadline:
 - For arrangements entered into pursuant to Exchange Act Rule 10b5-1(c) provided the reporting person does not select the date of execution; and
 - For example, a plan or arrangement providing for the sale of a specified number of securities on the last day of every month would not qualify under this exception

- For discretionary transactions pursuant to employee benefit plans where the reporting person does not select the date of execution
- Note that under both exceptions, the date of execution is deemed to be the date that the broker or plan administrator notifies the registered person of the transaction
- However, the notification date will be assumed to be made no later than the third business day following the trade date
 - Thus, even if actual notice does not occur, the maximum reporting period allowed is five business days
- Amended the small acquisitions rule under Rule 16a-6(b) to conform the filing period to the two-business day deadline on Form 4 if the acquisition no longer qualifies for deferred reporting on Form 5

Transactions Covered

All amendments adopted regarding the acceleration of reporting apply to transactions that occur on or after August 29, 2002. The amendments do not affect transactions that occurred before the effective date. In addition, transactions previously exempt from Section 16(a) reporting remain exempt under the new rules.

Electronic Filing and Website Posting

As mandated by the Sarbanes-Oxley Act, the SEC is presently working on rules that require companies, within one year, to electronically file change of beneficial ownership reports and post these reports on their websites. The statutory deadline for compliance with electronic filing is June 30, 2003. However, the SEC encourages all reporting persons and companies filing Section 16(a) reports on their behalf to make these filings electronically.

Remaining Issues

Several issues not addressed by Sarbanes-Oxley may be addressed by the SEC in the future. Specifically, detailed disclosure of director and executive officer arrangements intended to satisfy the affirmative defense conditions of 10b5-1(c) and company loans to directors and executives not prohibited by Section 402 of the Act.

Copies of the SEC proposal can be found at www.sec.gov. The SEC welcomes interested persons to submit comments on the amendments no later than September 30, 2002.

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General questions about this letter can be addressed to Louis C. Taormina in our New York office at 212-986-6330 or by e-mail at lctaormina@fwcook.com. Specific questions about the applicability of the new rules to a particular company's situation should be addressed to corporate counsel. Copies of this letter and published materials are available on our website at www.fwcook.com.