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SEC/CORPORATE

Meeting of the SEC Advisory Committee on Small and Emerging Companies

The Securities and Exchange Commission's Advisory Committee on Small and Emerging Companies met on March 4 to discuss various topics related to facilitating the secondary market for trading securities of small and emerging companies, including proposed rules under Regulation A+ and recommendations regarding the definition of "accredited investor."

In her opening remarks at the meeting, SEC Chair Mary Jo White emphasized the importance of secondary market liquidity and its impact on availability of capital for small businesses, as well as investor protection. Chair White noted that the SEC's staff in the Divisions of Corporation Finance and Trading and Markets have been looking at various ways to facilitate the secondary market trading of securities issued by small businesses, including through "appropriately structured venture exchanges."

In his opening statement to the meeting, SEC Commissioner Daniel M. Gallagher reiterated the importance of secondary liquidity. Commissioner Gallagher noted a need for "a positive, proactive capital formation agenda for small businesses," and that the Committee would be discussing two pieces of that agenda: (1) "enhancing secondary trading in private shares, both in general and through a focus on Rule 4(a)(1½)," and (2) secondary market trading, particularly through venture exchanges, which Commissioner Gallagher views as a "vital bookend" to the SEC's rulemaking on Regulation A+.

SEC Commissioner Luis A. Aguilar, in his remarks at the meeting, commented on investor protection issues that may result from recent proposed and final rules relating to the secondary trading market, such as Regulation A+ and crowdfunding, as well as with the proposed venture exchanges.

The Committee also provided Chair White with its recommendations regarding the definition of "accredited investor," expressing its view that any change to the definition should expand, not contract, the available pool of accredited investors (for example, including within the definition those investors who meet a sophistication test, regardless of their income or net worth). Specifically, the Committee recommended that (1) accredited investor thresholds going forward should adjust according to the consumer price index; and (2) rather than protecting investors by raising the accredited investor thresholds or excluding certain asset classes from the calculation to determine accredited investor status, the SEC should focus on enhanced enforcement efforts and increased investor education.

The full text of Chair White's remarks can be found here, Commissioner Gallagher's remarks can be found here and Commissioner Aguilar 's remarks can be found here.

FINANCIAL MARKETS

Financial Action Task Force Publishes Updated List of Deficient Jurisdictions

On February 27, the Financial Action Task Force (FATF), which is an inter-governmental body established to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system, published an updated list of jurisdictions that pose a risk to the international financial system.

The following two jurisdictions have been determined to be jurisdictions that FATF members and other jurisdictions should apply counter-measures to protect the international financial system from the on-going and substantial money laundering and terrorist financing risks:

- Democratic People's Republic of Korea (North Korea)
- Islamic Republic of Iran

The following three jurisdictions, which have previously been determined to have strategic anti-money laundering and terrorism financing deficiencies have still not made sufficient progress in addressing identified deficiencies, or have not committed to an action plan developed with the FATF to address the deficiencies. The FATF calls on its members to consider the risks arising from the deficiencies associated with each jurisdiction, as described below. The three jurisdictions are:

- People's Democratic Republic of Algeria
- Republic of Ecuador
- Republic of the Union of Myanmar

Details of the specific requirements relating to each country are set forth in the FATF release available here.

For more information on the FATF member jurisdictions and FATF initiatives, click here.

CFTC

CFTC to Host Roundtable on Cybersecurity and System Safeguards Testing

On March 18, Commodity Futures Trading Commission staff will hold a public roundtable on cybersecurity and system safeguards testing. The roundtable will focus on improving system safeguards testing requirements, including leveraging enhanced requirements such as independent testing. Panelists will discuss testing issues for various perspectives, including those of exchanges and clearinghouses, market participants, industry associations, organizations promulgating best practices and standards for cybersecurity, and other government agencies.

More information, including dial-in information, is available here.

LITIGATION

Supreme Court Limits Scope of SOX Anti-Shredding Provision

The US Supreme Court recently reversed the conviction of a commercial fisherman, John L. Yates, accused of violating 18 U.S.C. § 1519, also known as the anti-shredding provision of the Sarbanes-Oxley Act (SOX), holding that the term "tangible object" was limited to objects used to store information.

Yates, the appellant-defendant, was convicted of ordering his crew to toss undersized fish back into the sea to avoid detection by federal authorities that he had violated federal conservation regulations. He was charged and

convicted under 18 U.S.C. § 1519, which states, "Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or *tangible object* with the intent to impede, obstruct, or influence the investigation … of any department or agency of the United States" shall be fined, imprisoned or both. Yates moved for a judgment of acquittal, arguing that SOX's reference to a "tangible object" referred to objects used to store information, not fish. The District Court denied Yates' motion, following the US Court of Appeals for the Eleventh Circuit precedent that a "tangible object" under § 1519 need not be related to a "record" or "document."

The Supreme Court reversed Yates's conviction, holding that the term "tangible object" in 18 U.S.C. § 1519 "must be one used to record or preserve information" and that the fish tossed overboard did not fall into that category. The plurality stated that dictionary definitions are not "dispositive" of the meaning of "tangible object" and emphasized that, as part of SOX, the provision was passed to combat financial fraud, not to prohibit the destruction of any type of evidence.

Yates v. United States, No. 13-7451, 574 U.S. ___ (2015).

Banker Settles with SEC for Role in Olympus Scandal

The Securities and Exchange Commission agreed to a settlement with Hajime Sagawa related to his alleged role as the principal and minority owner of a broker-dealer that assisted Japan based Olympus Corporation in its concealment of losses by using offshore entities.

Over the course of more than a decade, Olympus executives are alleged to have hidden losses in offshore entities based in the Cayman and British Virgin Islands that they controlled but did not consolidate in Olympus financial statements. According to the SEC, these entities purchased poorly performing investments from Olympus with bank loans secured by assets owned by Olympus.

In order to repay these loans, Olympus retained Axes America, LLC, a registered broker-dealer managed by Sagawa, as its financial advisor for several transactions. The SEC claims that Olympus paid Axes disproportional fees for these transactions that were routed back to the offshore entities and were used to pay the bank loans. The SEC charged that Sagawa violated Section 17(a)(1) and 17(a)(3) of the Securities Act of 1933 and aided and abetted Olympus in violating Section 15(c)(1)(A) of the Securities and Exchange Act of 1934. The settlement bars Sagawa from the securities industry, but notably the SEC declined to impose a civil penalty based upon his cooperation with its investigation.

In the Matter of Hajime Sagawa, Admin. Proceeding File No. 3-16412 (SEC Feb. 27, 2015).

BANKING

New Volcker Guidance Helps Non-US Banks

The five US financial regulators that are responsible for implementation of Section 13 of the Bank Holding company Act of 1956 (Volcker Rule) have added new guidance in the form of an addition to their list of Frequently Asked Questions (FAQs) that will be helpful to non-US banks seeking to make use of the so-called "SOTUS Exemption" for investments in covered funds that are made solely outside the United States. Availability of the SOTUS Exemption is subject to several conditions, one of which is that "no ownership interest in the covered fund is offered for sale or sold to a resident of the United States . . ." (See 12 C.F.R. Section 248.13(b)(iii).) Many practitioners have been concerned that compliance of this condition would be impossible in relation to a fund marketed by a party other than the relevant banking entity. The new FAQs alleviate that concern by clarifying that the marketing condition applies solely to the activities of the foreign banking entity that is seeking to rely on the SOTUS Exemption (including its affiliates) and not to the marketing activities of third parties. A non-US bank can consequently qualify for the SOTUS Exemption with respect to a covered fund that has some US investors so long as the bank itself was not responsible for the sale of the ownership interests to those investors.

The new FAQs can be found here.

EU DEVELOPMENTS

European Court Sides with the United Kingdom on Euro Clearing

On March 4, Europe's second-highest court ruled in favor of the United Kingdom in a long-running dispute with the European Central Bank (ECB) regarding the latter's right to mandate that central counterparties (CCPs) clearing euro-denominated business be located in the Eurozone. Specifically, the United Kingdom challenged the ECB's so-called "location policy" as set out in its 2011 "Eurosystem Oversight Policy Framework," which purported to establish a requirement that a CCP must be legally incorporated in the Eurozone, and maintain full managerial and operational control and responsibility from within the Eurozone, to the extent that such CCP exceeds certain thresholds of clearing activity in respect of one or more major euro-denominated product categories. Consequently, any CCP located outside the 19-member bloc of EU Member States using the euro — for example a CCP based in the United Kingdom or in Sweden— would face significant interruption to its euro-denominated clearing activities if the ECB's location policy was enforced.

A three-member panel of the Luxembourg-based General Court dismissed the ECB's argument that the Policy Framework was not a legal act subject to challenge, instead finding that the Policy Framework had sufficient legal effects to be challenged and that the United Kingdom had standing to make such challenge. The General Court then considered the substance of the challenge, and determined that the ECB's powers under European law to regulate payment systems did not extend to securities clearing systems. The General Court then annulled the Policy Framework "in so far as it sets a requirement to be located within a Member State party to the Eurosystem for [CCPs] involved in the clearing of securities." The scope of the court's ruling therefore appears to be restricted to the clearing of euro-denominated securities by non-Eurozone CCPs, and therefore the impact on non-Eurozone CCPs clearing other euro-denominated products such as derivatives remains unclear. The ECB has two months from the date of the ruling to file an appeal to the European Court of Justice.

The General Court's judgment can be found here. The Policy Framework can be found here.

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