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SEC/CORPORATE

SEC Division of Corporate Finance Issues New CD&Is Relating to General Solicitation and Regulation D

On August 6, the Staff of the Division of Corporate Finance of the Securities and Exchange Commission (Staff) released new Compliance and Disclosure Interpretations (C&DIs) relating to "general solicitation" under Rule 502(c) of the Securities Act of 1933, including guidance as to the Staff's position that a pre-existing, substantive relationship by an issuer or its agent with an investor is evidence that the offer and sale of securities to such investor did not involve a general solicitation. The new C&DIs also provide guidance relating to Form D (the form filed in connection with a Regulation D offering).

In the new C&DIs, the Staff provides the following guidance:

- **Pre-Existing, Substantive Relationships.**
  - The existence of a pre-existing, substantive relationship is one way (but not the only way) of demonstrating the absence of a general solicitation in a Regulation D offering.
  - A relationship is "substantive" for purposes of demonstrating absence of general solicitation when an issuer (or a person acting on its behalf) has sufficient information to, and does in fact, evaluate a prospective offeree's financial circumstances and sophistication in order to determine if the offeree is an accredited or sophisticated investor. Self-certification alone is not sufficient.
  - In addition to a broker-dealer, the Staff believes that an investment adviser registered with the SEC may be able to form a pre-existing relationship with a prospective offeree that is a client of the adviser, based on its fiduciary duty to provide suitable investment advice to its client.
  - Third parties other than registered broker-dealers and investment advisers may be able to form pre-existing, substantive relationships with a prospective offeree, depending on the particular facts and circumstances. In the absence of a prior business relationship or a legal duty to offerees, it may be difficult for an issuer itself to establish a pre-existing, substantive relationship with a prospective offeree. The Staff suggests that, in this instance, an issuer may consider conducting an offering in accordance with Rule 506(c) (under which general solicitation is permitted so long as other requirements are satisfied) in order to provide greater certainty that an exemption would be available for the offering.
  - A "pre-existing relationship" for purposes of demonstrating the absence of a general solicitation under Rule 502(c) is one that is formed with an offeree prior to the commencement of the securities offering or, alternatively, that was established through either a registered broker-dealer or an investment adviser prior to the broker-dealer's or investment adviser's participation in the offering.
  - There is no minimum waiting period required for an issuer, or a person acting on its behalf, to establish a pre-existing, substantive relationship with a prospective offeree in order to demonstrate that there is no general solicitation. The issuer must have established, however, such a relationship prior to the commencement of the offering or, if the relationship was through a broker-dealer or investment adviser, prior to the broker-dealer's or investment adviser's participation in the offering.
  - However, in the case of private fund offerings made on a semi-continuous basis, the Staff has allowed a limited accommodation for offerings by private funds that rely on specified exclusions from the definition of "investment company" set forth in the Investment Company Act. This limited

accommodation permits an individual who qualifies as an accredited or sophisticated investor to purchase, after the end of a waiting period, securities in private fund offerings that were posted on a website platform prior to the investor's subscription to the platform.

- There are circumstances under which an issuer, or a person acting on its behalf, may communicate information about an offering to persons with whom it does not have a pre-existing, substantive relationship without involving a general solicitation. For example, the Staff acknowledges the use of networks of investors experienced in investing in private offerings, where such investors share offering information with the other members of the network and the issuer may have a relationship with one of such investors. An issuer may contact other members of such a group and be able to establish a reasonable belief that these other members of the network have the necessary financial experience and sophistication, such that it may not constitute a general solicitation.

- **Issuer Information.**
  - Information that does not involve an offer of securities, including "factual business information" that does not condition the public for an offering, may be disseminated widely without violating Rule 502(c).
  - What constitutes "factual business information" is a facts and circumstances analysis, but is typically limited to information about the issuer, its business, financial condition, products, services, or advertisement of such products or services. The information must be presented, however, in such a manner as not to constitute an offer of the issuer's securities. Factual business information generally does not include predictions, projections, forecasts or opinions with respect to valuation of a security, nor for a continuously offered fund would it include information about past performance of the fund.

- **Use of Publicly Available Websites.** The use of an unrestricted, publicly available website to offer or sell securities constitutes a general solicitation.

- **Demo Days and Venture Fairs.** A demo day or a venture fair does not necessarily constitute a general solicitation for purposes of Rule 502(c); the determination is dependent on the facts and circumstances at issue, including as to whether a presentation involves the offer of a security.

- **Form D – Sales Compensation.** If the information requested on Item 12 of Form D is not applicable to its Regulation D offering because the issuer has not paid or does not expect to pay any commission or similar compensation in connection with the sale of its securities, the issuer should not enter any information in any fields under Item 12.

BROKER-DEALER

Web Based Surveillance Reports

In a regulatory circular to Trading Permit Holders (TPHs), the Chicago Board Options Exchange (CBOE) announced that as of August 10 it has made the Book Trade Through Surveillance Reports available to TPHs on its Web Based Surveillance Firm Reports page. The Reports highlight when CBOE Rules 6.45A or B have been violated. These Rules set forth, among other things, the manner in which electronic Hybrid System trades in options are prioritized and allocated. In particular, the Rules prevent order entry firms from executing their own orders without first giving TPHs, that are already bidding or offering, an opportunity to trade with the agency order or to trade at the execution price. Reports are posted if an exception has been generated and are currently posted for trade dates from January 2 through the present.

For additional information regarding Web Based Surveillance Reports click here.

DERIVATIVES

See "CFTC Extends Relief for Non-US Swap Dealers From Transaction-Level Requirements" in the CFTC section.

CFTC

HKSFC Issues Circular on Application Process for Exemptive Relief Under CFTC Regulation 30.10

On August 13, the Hong Kong Securities and Futures Commission (HKSFC) issued a circular describing the application procedure for certain licensed corporations to deal directly with customers in the United States pursuant to Commodity Futures Trading Commission Regulation 30.10. As reported in the March 20 edition of *Corporate & Financial Weekly Digest*, the CFTC issued an order permitting HKSFC-licensed corporations to deal directly with US customers for trading on any exchange subject to HKSFC's oversight without having to register with the CFTC as future commission merchants.

To be eligible for the exemption, the licensed corporation must: (1) be licensed by HKSFC for regulated futures activity (Type 2-licensed corporation); (2) trade on behalf of customers in Hong Kong and intend to trade on behalf of customers in the United States; and (3) be located outside of the United States. A licensed corporation interested in obtaining the exemption pursuant to the CFTC Regulation 30.10 order must submit to HKSFC an application letter addressed to the National Futures Association (NFA) and an agency agreement signed by both the licensed corporation and its appointed agent for service of process in the United States. The licensed corporation is also required to provide written representations and certifications to HKSFC and NFA. Upon receipt of the application, HKSFC will notify the CFTC and forward the application package to NFA. Pending NFA's approval, HKSFC will notify the licensed corporation of exemptive relief.

Licensed corporations granted relief pursuant to the CFTC Regulation 30.10 order are required to notify HKSFC and NFA of any material changes to any of the representations made in or in support of the application for exemptive relief.

HKSFC's circular, which includes templates for certain application materials, is available here.

CFTC Extends Relief for Non-US Swap Dealers From Transaction-Level Requirements

On August 13, the Division of Swap Dealer and Intermediary Oversight, Division of Clearing and Risk, and Division of Market Oversight of the Commodity Futures Trading Commission extended no-action relief from certain transaction-level requirements to non-US swap dealers (SDs) using personnel or agents located in the United States to effect swap transactions.

Pursuant to the relief, non-US SDs that use personnel or agents located in the United States to arrange, negotiate or execute swaps with non-US persons that are not SDs are exempt from the transaction-level requirements for such swaps. The relief from transaction-level requirements also extends to a swap with another non-US SD; however, in such case, the non-US SD using US-located personnel or agents would be required to comply with the multilateral portfolio compression and swap trading relationship requirements under CFTC Regulations 23.503 and 23.504, respectively.

The relief expires prior to the earlier of: (1) September 30, 2016, or (2) the effective date of any CFTC action addressing certain compliance issues implicated by transaction-level requirements.

CFTC Letter No. 15-48 is available here.

BANKING

Federal Reserve Issues Clarification of Debit Card Interchange Rule in Response to Court Action

On August 10, the Board of Governors of the Federal Reserve System (Board) clarified Regulation II (Debit Card Interchange Fees and Routing) regarding the inclusion of transaction-monitoring costs in the interchange fee standard.

Regulation II implements, among other things, standards for assessing whether interchange transaction fees for electronic debit transactions are reasonable and proportional to the cost incurred by the issuer, as required by

section 920 of the Electronic Fund Transfer Act (EFTA). On March 21, 2014, the US Court of Appeals for the DC Circuit reversed an earlier decision by the US District Court for the District of Columbia and largely upheld Regulation II against a challenge to the rule by merchant groups. The court of appeals found that one aspect of the rule—the Board's inclusion of transaction-monitoring costs in the interchange fee standard—required further explanation, and remanded the matter for further proceedings. Specifically, the court of appeals agreed with the Board's position that "transactions-monitoring costs can reasonably qualify both as costs 'specific to a particular transaction' (section 920(a)(4)(B)) and as fraud-prevention costs (section 920(a)(5))." The court held, however, that the Board had not adequately articulated its reasons for including transactions-monitoring in the interchange fee standard rather than in the fraud-prevention adjustment. Among other rationales, the Board explained the following:

> Section 920(a)(4)(B) [of the EFTA] specifically directs the Board to consider in establishing the interchange fee standard the costs "incurred by the issuer for the role of the issuer in the authorization, clearance or settlement of a particular transaction." Transactions-monitoring is an integral part of the authorization process, so that the costs incurred in that process are part of the authorization costs that the Board is required by the statute to consider when establishing the interchange fee standard.

It remains to be seen what action, if any, various challengers to the rule will take following the issuance of the clarification by the Board.

Read more.

UK DEVELOPMENTS

UK Companies Must Maintain a PSC Register by January 2016

The *Corporate & Financial Weekly Digest* edition of October 17, 2014, discussed the Small Business, Enterprise and Employment Act 2015 (SBEE) and the potential impact the proposed transparency provisions will have on UK corporate structures and limited liability partnerships and the potential impact these rules will have on UK Crown Dependencies and Overseas Territories. The SBEE received Royal Assent on March 26 and certain provisions have come into force while other provisions remain the subject of further consultation and draft regulations.

Notably, two months following Royal Assent, the SBEE's prohibitions on bearer shares came into effect. While previously the Department for Business, Innovation and Skills (BIS) had intended on applying the prohibition on corporate directors as of October 2015, they have since announced a postponement until April 2016, pending the outcome of a consultation that closed on April 27.

One of the more important changes contained in the SBEE relates to the new obligation for companies to keep and maintain a register (Register) of people with significant control (PSC) over the company (PSC Register), which applies from January 2016, and the PSC Register must then be provided to Companies House from April 2016, when companies deliver their annual confirmation statement. Once provided to Companies House, the information will be publicly searchable unless a waiver can be obtained under the SBEE's protection regime.

The initial step for a company is to determine whether an individual or entity is a PSC, and the consultation helpfully explains that a PSC is any person who satisfies one or more of the following conditions:

- directly or indirectly owns more than 25 percent of the shares in the company;
- directly or indirectly holds more than 25 percent of the voting rights in the company;
- directly or indirectly has the power to appoint or remove the majority of the board of directors of the company;
- otherwise has the right to exercise significant influence or control over the company; or
- has the right to exercise or actually exercises significant influence or control over a trust or firm that is not a legal entity, which in turn satisfies any of the first four conditions over the company.

Entities that satisfy at least one of the conditions above and are either (1) a DTR 5 issuer or (2) are required to hold a PSC Register itself, are referred to in the SBEE as a "relevant legal entity."

Once a PSC is identified, the next step is to determine whether the PSC is registrable or non-registrable. If the ownership structure involves a chain of companies that are relevant legal entities, then only the first company in the chain is registrable and all of the other companies further up the chain are non-registrable from the perspective of the relevant company. That is because each of the successive corporate owners has a similar obligation and will maintain its own register. A chain of companies exists for the purposes of the SBEE only if each company in the chain holds a "majority stake" in the entity immediately below it in the chain. A "majority stake" is defined in the SBEE and generally applies the same tests as set out above in determining whether a person is a PSC.

The BIS also recently closed a consultation that sought views on (1) the type of information required for the PSC Register, (2) the protection, (3) exemptions, (4) sanctions and penalties, and (5) fees chargeable by a company to provide copies of a Register entry. The BIS is holding additional consultations to seek views on how the PSC Register should apply to LLPs and how foreign limited partnerships should be treated if they own or control a UK company.

Companies should expect detailed guidance on the PSC Register from the BIS to be published this autumn.

There are further potential changes to the PSC Register due to the Fourth EU Money Laundering Directive (MLD), which came into force on June 24 and must be implemented by member states by June 26, 2017, which also requires disclosures regarding beneficial owners. Similar to the PSC Register, the MLD requires legal entities to obtain and maintain accurate information on their beneficial owners, and must provide that information to a central register. However, the MLD is broader in scope and until the MLD is transposed into local law there remains some uncertainty of what changes, if any, will be required to a company's disclosure obligations.

EU DEVELOPMENTS

EU Securities Financing Transactions Regulation––Shining a Light on Shadow Banking

On June 29, the Council of the European Union announced that its Permanent Representatives Committee (Coreper) approved a final compromise text of the proposed regulation on reporting and transparency of securities financing transactions (SFT Regulation). The compromise brings consensus to variations between the European Commission's proposal published on January 29, 2014 (2014/0017 (COD)) and the European Parliament's draft report. The final text of the compromise text, which can be found here, was published along with an "I" item note inviting the Coreper to agree. If approved by the Parliament on October 27 as anticipated, the SFT Regulation could be in force as early as the first calendar quarter of 2016. The SFT Regulation is intended to provide transparency in securities financing transactions and is part of the Financial Stability Board's and European Union's initiative on "shadow banking."

Generally an SFT includes any transaction that uses assets of one counterparty to generate financing (i.e., repos, reverse repos, securities lending, buy/sell back and sell/buy back transactions and margin lending transactions) where at least one of the counterparties has a nexus to the European Union.

The SFT Regulation will now require (1) counterparties to these transactions to report the details of each transaction to a designated trade repository, (2) Undertakings for the Collective Investment of Transferrable Securities (UCITS) management companies and Alternative Investment Fund Managers (AIFMs) to provide pre-contractual and ongoing disclosures to investors regarding a collective investment scheme's use of SFTs, and (3) rights of reuse of collateral, which are in addition to several existing EU requirements with respect to collateral arrangements.

Market participants (including companies, proprietary trading firms and hedge funds) that engage in an SFT where an EU counterparty is involved will be affected by the SFT Regulation.

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