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## BREXIT UPDATE

Nathaniel Lalone, a Financial Services partner at Katten Muchin Rosenman UK LLP, will continue to share his insight into the evolution of the relationship between the United Kingdom and European Union in the wake of the Brexit vote. On July 13, he published an article in *Bloomberg Law* on the issue of the "passport," which refers to the principle that a financial market participant authorized to conduct certain financial activities in one EU member state is generally free to conduct such activities without hindrance in other EU member states.

To read the *Bloomberg Law* article, click here.

## SEC/CORPORATE

### SEC Division of Corporation Finance Issues New C&DIs on A/B Exchanges

The staff of the Securities and Exchange Commission, through a series of letters, which began with a 1988 no-action letter to Exxon Capital Holdings Corporation, has taken the position that, when an issuer has privately sold non-convertible debt or other securities (Original Securities) to large, sophisticated investors, the issuer may register the exchange (A/B Exchange) of the Original Securities for substantially similar securities (Exchange Securities) that can be resold by most holders thereof (Exchange Recipients) without further registration or delivery of a prospectus. One reason for the SEC's position as to A/B Exchanges is that the participants in such an exchange are not engaged in a distribution of the Exchange Securities (unless the participants are underwriters). As a condition to the SEC not objecting to the registration of the Exchange Securities issued in A/B Exchanges, the staff of the SEC has requested that the issuer of the Exchange Securities make certain representations. On July 11, the SEC issued two new Compliance and Disclosure Interpretations (C&DIs), which are duplicative of each other, to clarify that, although there is no particular form that the representations must take, the issuer does need to represent that the issuer:

- is not aware of any Exchange Recipient participating in the A/B Exchange with a view to distribute the Exchange Securities following its completion, and does not have any arrangement or understanding with any Exchange Recipient to facilitate, enable or engage in the foregoing;
- will disclose to each Exchange Recipient that, if such Exchange Recipient acquires the Exchange Securities for the purpose of distributing them, such Exchange Recipient:
    - cannot rely on the staff's interpretive position expressed in the Exxon Capital series of no-action letters with respect to A/B Exchanges, and
    - must comply with the registration and prospectus delivery requirements of the Securities Act of 1933, as amended (Securities Act), in order to resell the Exchange Securities, and be identified as an underwriter in the prospectus; and
- will include in the transmittal letter:
    - an acknowledgement to be executed by each Exchange Recipient that such Exchange Recipient does not intend to engage in a distribution of the Exchange Securities, and

- an acknowledgement for each Exchange Recipient that is a broker-dealer exchanging securities it acquired for its own account as a result of market-making activities or other trading activities that such broker-dealer Exchange Recipient will satisfy any prospectus delivery requirements in connection with any resale of Exchange Securities received pursuant to the A/B Exchange. The transmittal letter may also include a statement to the effect that by so acknowledging and by delivering a prospectus, a broker-dealer Exchange Recipient will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act.

In the C&DIs, the staff of the SEC noted that these representations can either be included in the issuer's prospectus or in correspondence submitted in connection with the filing.

The complete text of the new A/B Exchange C&DIs can be found here.

### SEC Proposes Amendments To Update and Simplify Disclosure Requirements

On July 13, the Securities and Exchange Commission proposed rule amendments to update and simplify certain disclosure requirements that may have become "redundant, duplicative, overlapping, outdated or superseded." The proposal comes as a result of the SEC staff's ongoing work to improve disclosure for both investors and companies and aims to address disclosure inefficiencies as follows:

- *Duplicative Requirements.*
  Deletion of requirements that require substantially the same disclosures as: (1) US generally accepted accounting principles (GAAP); (2) International Financial Reporting Standards (IFRS); and (3) other SEC disclosure requirements.
- *Overlapping Requirements.*
  Deletion or integration of requirements that (1) convey reasonably similar information to, (2) are encompassed by disclosures that result from compliance with, or (3) require disclosure incremental to overlapping requirements of, GAAP, IFRS or other SEC disclosure requirements.
- *Outdated Requirements.*
  Deletion or amendment of requirements that have become obsolete over time or due to regulatory, business or technological changes.
- *Superseded Requirements.*
  Deletion or amendment of requirements inconsistent with recent legislation or more recently updated SEC or GAAP requirements.

The SEC's press release, which contains a fact sheet regarding the proposing release, can be found here. These proposed amendments will be addressed in greater detail in a future edition of *Corporate & Financial Weekly Digest*.

## BROKER-DEALER

### New Proposed SEC Rules for the Disclosure of Order Handling Information

On July 13, the Securities and Exchange Commission voted to propose rules requiring broker-dealers to disclose the handling of institutional orders to customers for the first time and to expand existing retail order disclosures (Proposed Rules). The Proposed Rules seek to allow customers to more effectively monitor the services provided by their broker-dealers and to compare the routing decisions and execution quality of multiple broker-dealers.

The Proposed Rules would require broker-dealers, upon request from a customer, to provide a monthly report for the previous six-month period detailing the handling of such customer's institutional orders in exchange-listed stocks with an original market value of at least $200,000. The report would be required to include information such as shares sent to the broker-dealer, shares executed by the broker-dealer as principal and information with respect to venues to which the broker-dealer routed institutional orders for the customer. Required information would have to be presented in the aggregate and broken down by order routing strategy (passive, neutral or aggressive). Broker-dealers will also have to make public aggregated reports pertaining to their handling of institutional orders on a quarterly basis for information pertaining to the three previous years.

The Proposed Rules also will require broker-dealers to disclose retail order routing information such as: (1) limit orders as marketable or non-marketable; (2) routing information by calendar month; (3) information pertaining to payments to certain venues; and (4) a description of terms of payment for order flow or profit-sharing arrangements that may influence a broker-dealer's order routing decision. Market centers would be required to make public order handling reports for three years.

The Proposed Rules will be subject to a 60-day comment period from their date of publication in the *Federal Register*. The SEC's announcement can be found here.

# PRIVATE INVESTMENT FUNDS

*See "SEC Increases Dollar Amount of the Net Worth Threshold Test for "Qualified Clients" in Rule 205-3 Under the Investment Advisers Act of 1940" in the Investment Companies and Investment Advisors section.*

# DERIVATIVES

### SEC Adopts Changes to Security-Based Swap Reporting Rules

On July 13, the Securities and Exchange Commission adopted a miscellaneous set of amendments to, and issued some guidance concerning, its rules for the reporting on security-based swaps (SBSs). The amendments create the following new obligations related to reporting:

- A national securities exchange or security-based swap execution facility must report any SBS executed on the platform that will be submitted to clearing.
- A registered clearing agency must report any SBS to which it is a direct counterparty.
- An SBS data repository is prohibited from imposing fees or usage restrictions on the SBS transaction data that it is required by Regulation SBSR to publicly disseminate.
- A non-US person must report any SBS another non-US person that would otherwise be exempt from reporting if the SBS is arranged, negotiated, or executed by personnel or agents of such non-US person located in the United States.

The extensive guidance provided deals primarily with two topics. The first is the reporting of bunched order executions of cleared SBSs by investment managers and the second is the reporting of SBS involving prime brokers.

The SEC also adopted a final framework for phasing in compliance with the full suite of SBS reporting rules that includes three stages. Under this framework, SBS reporting will commence on Compliance Date 1, which is the first Monday on or after the later of (1) six months after the registration of the first SBS data repository, and (2) one month after the first date on which SBS dealers are required to register. Public dissemination of reported information about SBS will begin on Compliance Date 2, which is three months after Compliance Date 1. Finally, reporting of historical SBS (i.e., pre-enactment SBS executed before July 21, 2010 and transitional SBS executed between that date and Compliance Date 1) will begin on Compliance Date 3, which is two months after Compliance Date 2 (and therefore five months after Compliance Date 1).

The text of the amendments and guidance is available here.

# CFTC

### CFTC Extends Public Comment Period for ICE Futures U.S. Block Trade Rule Change

The Division of Market Oversight of the Commodity Futures Trading Commission has extended the public comment period with regard to the proposal by ICE Futures U.S. (IFUS) to allow pre-hedging or anticipatory hedging in certain circumstances in connection with block trades reported to IFUS. For further details on IFUS's proposal, see the *Corporate & Financial Weekly Digest* edition of June 17.

The comment period has been extended an additional 15 days and will end on July 29. Implementation of the proposal will be stayed an additional 45 days, until October 26.

Comments may be submitted through the CFTC's website here. Additional information is available here.

# INVESTMENT COMPANIES AND INVESTMENT ADVISERS

### SEC Increases Dollar Amount of the Net Worth Threshold Test for "Qualified Clients" in Rule 205-3 Under the Investment Advisers Act of 1940

Section 205 under the Investment Advisers Act of 1940 generally prohibits a federally registered investment adviser (RIA) from receiving compensation based on a share of the capital gains on or appreciation of the assets of an advisory client (i.e., performance fees). Rule 205-3 under the Advisers Act provides an exemption from this prohibition for clients that meet the definition of "Qualified Client" found in the rule.

Currently, the definition of Qualified Client includes, among other persons, a company that, or a natural person who:

- has at least $1 million of assets under the management of the RIA; or
- has a net worth (together, in the case of a client that is a natural person, with assets held jointly with a spouse) that the RIA reasonably believes to be in excess of $2 million.

On June 14, the Securities and Exchange Commission issued an order increasing the dollar amount of the net worth threshold in Rule 205-3 from $2 million to $2.1 million, effective as of August 15. The increase in the net worth threshold is based on adjustments for inflation. The dollar amount of the required assets under management threshold under Rule 205-3 will remain at $1 million.

The change impacts performance fees charged to private funds that rely on Section 3(c)(1) of the Investment Company Act of 1940, as well as to separately managed accounts. RIAs who charge performance fees should revise applicable net worth representations in their investment advisory agreements and in 3(c)(1) fund subscription agreements to reflect the updated threshold for new separately managed account clients and 3(c)(1) fund investors.

However, Rule 205-3 specifically provides that existing investors and clients that no longer meet the new net worth threshold can continue to be charged performance fees provided they met the net worth threshold at the time they entered into the advisory contract under which they are charged such performance fees.

The SEC order is available here.

# EU DEVELOPMENTS

### European Commission Adopts EU-US Privacy Shield

On July 12, the European Commission (EC) published an implementing decision (Adequacy Decision) under the EU directive on the protection of individuals with regard to the processing and free movement of personal data (Directive). The Adequacy Decision responds to the uncertainty in relation to transatlantic transfers of personal data introduced by the European Court of Justice findings in October 2015 that the previous EU-US safe harbor framework was invalid. The EC therefore has decided that the new "EU-US Privacy Shield" framework (Privacy Shield) provides an adequate level of protection in the United States for personal data transfers under the Directive. The Privacy Shield consists of principles issued by the US Department of Commerce (Principles), which are contained in annex II of the Adequacy Decision, as well as other letters and mechanisms to safeguard data protection.

The Adequacy Decision is designed to streamline transfers of personal data between the European Union and the United States; however, US organizations wishing to benefit from the Privacy Shield will need to meet certain requirements. Only US–based organizations that self-certify and declare their commitment to the Principles will be included on a list maintained by the US Department of Commerce (List), and only personal data transfers to organizations on the List will benefit from the Privacy Shield (and thus, the Adequacy Decision). Under the Principles, US organizations also will be required to publish their privacy policies and give notice to individuals of their participation in the Privacy Shield, and comply with other requirements in relation to choice, access, security, onward transfer of personal data and independent recourse.

The Adequacy Decision went into effect in the European Union on the date of its announcement, July 12, and will be operative in the United States once the framework is published in the *Federal Register*. The US Department of Commerce expects to begin accepting self-certifications on August 1.

As noted in the *Corporate & Financial Weekly Digest* edition of June 24, subject to the post-Brexit relationship agreement between the United Kingdom and the European Union, the United Kingdom may lose the benefit of equivalence decisions and frameworks, such as the Privacy Shield, negotiated on behalf of EU Member States once the United Kingdom formally leaves the European Union.

A copy of the Adequacy Decision can be found here, and associated annexes (including the Principles in annex II), can be found here.

A copy of the EC's accompanying press release can be found here.

### ESMA Publishes Responses to Benchmark Regulation Consultation

On July 7, the European Securities and Markets Authority (ESMA) published responses (Responses) received in relation to a consultation paper (Consultation Paper) on draft technical advice under the EU regulation on indices used as benchmarks in financial instruments and financial contracts (Benchmarks Regulation) originally published in May 2016. The Responses address certain definitions, measurements in relation to the use of critical and significant benchmarks, criteria for identifying critical benchmarks, endorsement of third-country benchmarks and transitional provisions under the Benchmarks Regulation.

The Benchmarks Regulation went into effect on June 30, and ESMA expects to submit final technical advice to the European Commission within four months of this date.

Copies of the Responses can be found here.

ESMA's original Consultation Paper can be found here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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