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SEC / CORPORATE

SEC Division of Corporation Finance Issues Five Additional C&DIs Relating to Pay Ratio Disclosure Rule

On October 18, the Securities and Exchange Commission's Division of Corporation Finance (Division) issued five new Compliance and Disclosure Interpretations (C&DIs) with respect to Item 402(u) of Regulation S-K, the rule that requires a registrant to disclose the ratio of its principal executive officer's total annual compensation to the total annual compensation of their median employee (the "Pay Ratio Disclosure Rule"). The new C&DIs include the following interpretive guidance:

1. The Pay Ratio Disclosure Rule permits registrants to identify the median employee by using annual total compensation or any other consistently applied compensation measure (CACM) that is applied to all employees. C&DI 128C.01 provides that registrants may use any CACM that *reasonably reflects the annual compensation of employees.* For example, (a) total cash compensation might constitute a CACM for a registrant, but not if equity awards are widely distributed among such registrant's employees, and (b) Social Security taxes withheld would likely not be a CACM for a registrant unless all of such registrant's employees earned less than the Social Security wage base.

2. C&DI 128C.02 provides that a registrant may not exclusively use hourly or annual rates of pay as its CACM for purposes of identifying the median employee without, for example, taking into account the number of hours actually worked by hourly employees or the portion of the year actually worked by employees with an annual compensation rate.

3. C&DI 128C.03 provides that, in applying the applicable CACM, a registrant need not use (a) a period that includes the date on which the employee population is determined nor (b) a full annual period. Furthermore, C&DI 128C.03 provides that a registrant may use a prior fiscal year's annual total compensation as its CACM so long as there have not been changes in such registrant's employee population or compensation arrangements that would significantly impact pay distribution within such population.

4. C&DI 128C.04 provides that the inclusion of the compensation of furloughed employees in identifying the median employee needs to be determined by each registrant, based on the facts and circumstances specific to that registrant. Furloughed employees are not defined or addressed specifically in the Pay Ratio Disclosure Rule, and the Division's interpretation is that a registrant must determine whether a furloughed employee belongs, as of the date the employee population is determined, in one of the four classes of employees identified in the Pay Ratio Disclosure Rule—full-time, part-time, temporary and seasonal. The registrant must then determine such furloughed employee's compensation using the applicable CACM, on the same basis as non-furloughed employees in that category (e.g., annualizing the compensation of a full- or part-time permanent employment, but not of a temporary or seasonal employee). The C&DI also reminds registrants that they may not make a full-time equivalent adjustment for any employee.

5. Under the Pay Ratio Disclosure Rule, an "employee" of the registrant does not include a worker who is employed, and whose compensation is determined, by an unaffiliated third party but who provides services to the registrant or its consolidated subsidiaries as an independent contractor or leased worker. C&DI 128C.05 makes clear that, in determining when a worker is an "employee" of the registrant under

the Pay Ratio Disclosure Rule, a registrant has to take into account the composition of its workforce and its overall employment and compensation practices. A registrant should include those workers whose pay it determines, regardless of how those workers are classified for employment or tax purposes. The Division further indicates that the registrant's specification of a minimum level of compensation for workers whose service the registrant obtains by contracting with an unaffiliated third party should not make those workers employees for purposes of the Pay Ratio Disclosure Rule. Additionally, an individual independent contractor may be the "unaffiliated third party" who determines his or her own compensation.

The original text of the C&DIs is available here.

BROKER-DEALER

SEC Approves FINRA's Capital Acquisition Broker Rules

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's new rules governing firms that meet the definition of "capital acquisition broker" (CAB) and elect to be governed by the new CAB rules. (The *Corporate & Financial Weekly Digest* edition of January 8, 2016 summarized FINRA's proposed CAB rules.)

Under the new rules, CABs are firms that engage in a limited set of activities related to advising companies and private equity funds on capital raising and corporate restructuring, and acting as a placement agent for sales of unregistered securities to institutional investors. As discussed in greater detail below, CABs are subject to a streamlined set of FINRA rules. However, CABs are prohibited from various activities that are otherwise permitted for full-service broker-dealers, including carrying or acting as an introducing broker with respect to customer accounts, holding or handling customers' funds or securities, accepting customers' orders, and engaging in proprietary trading or market-making activities.

Under the new rules, CABs are subject to a streamlined set of rules governing conduct, supervision, financial and operational obligations, and investigations, sanctions and disciplinary proceedings. With respect to conduct rules, CABs are subject to CAB Rule 221 (Communications with the Public), which is a streamlined version of FINRA Rule 2210 (Communications with the Public). CABs are not subject to FINRA Rule 2121 (Fair Prices and Commissions), 2122 (Charges for Services Performed) or FINRA Rule 2124 (Net Transactions with Customers).

With respect to supervisory rules, CABs are subject to FINRA Rule 3220 (Influencing or Rewarding Employees of Others), FINRA Rule 3240 (Borrowing from or Lending to Customers) and FINRA Rule 3270 (Outside Business Activities of Registered Persons). In addition, CAB Rule 311 (Capital Acquisition Broker Compliance and Supervision), CAB Rule 313 (Designation of Chief Compliance Officer) and CAB Rule 331 (Anti-Money Laundering Compliance Program) include some, but not all, of the obligations set forth in existing FINRA Rule 3110 (Supervision), FINRA Rule 3130 (Annual Certification of Compliance and Supervisory Processes) and FINRA Rule 3310 (Anti-Money Laundering Compliance Program), respectively.

With respect to financial and operational rules, CABs are subject to CAB Rule 411 (Capital Compliance), which includes some, but not all, of the capital compliance requirements of FINRA Rule 4110 (Capital Compliance). CABs are not subject to FINRA Rule 4370 (Business Continuity Plans and Emergency Contact Information) or FINRA Rule 4380 (Mandatory Participation in FINRA BC/DR Testing Under Regulation SCI).

With respect to rules governing investigations, sanctions and disciplinary proceedings, CABs are subject to a narrower set of rules. For example, CABs are not subject to FINRA Rule 8110 (Availability of Manual to Customers), FINRA Rule 8211 (Automated Submission of Trading Data Requested by FINRA) and FINRA Rule (Automated Submission of Trading Data for Non-Exchange-Listed Securities Requested by FINRA). CABs also are not subject to the FINRA Rule 9700 Series (Procedures on Grievances Concerning the Automated Systems).

The new rules also provide that CABs are subject to FINRA Rule 5122 (Private Placements of Securities Issued by Members) and FINRA Rule 5150 (Fairness Opinions), as well as FINRA Rule 12000 Series (Code of Arbitration Procedure for Customer Disputes), FINRA Rule 13000 Series (Code of Arbitration Procedure for Industry Disputes) and FINRA Rule 14000 Series (Code of Mediation Procedure).

The CAB rules will go into effect on April 14, 2017. FINRA will begin accepting applications for firms seeking to become CABs on January 3, 2017.

More information on FINRA Regulatory Notice 16-37 is available here. The CAB rules are available on FINRA's website, here.

SEC Approves FINRA's TRACE Amendments for CMO Transactions

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's amendments to its Trade Reporting and Compliance Engine (TRACE) rules to provide for dissemination of transactions in collateralized mortgage obligations (CMOs), and to reduce the reporting time for CMO transactions. Specifically, FINRA will disseminate trade-by-trade information relative to CMO transactions valued under $1 million immediately upon receipt of the transaction report. For CMO transactions valued at $1 million or more, and where there have been five or more transactions in that security of $1 million or more by at least two different market participants, FINRA will disseminate aggregated information relative to transactions in that security on a weekly and monthly basis. CMO transactions that do not meet the criteria for either immediate trade-by-trade dissemination or periodic aggregate dissemination will not be subject to public dissemination.

The revised TRACE rules also provide that CMO transactions executed on or after issuance must be reported to TRACE within 60 minutes of execution. CMO transactions executed before the date of issuance must be reported to TRACE no later than the first settlement date of the security.

The TRACE amendments for CMO transactions will go into effect on March 20, 2017.

More information on FINRA Regulatory Notice 16-38 is available here.

SEC Approves FINRA's TRACE Amendments for US Treasury Securities

The Securities and Exchange Commission has approved the Financial Industry Regulatory Authority's amendments to its Trade Reporting and Compliance Engine (TRACE) rules to provide for reporting of transactions in "US Treasury securities," which includes all securities issued by the US Treasury Department, with the exception of savings bonds. As a consequence, the TRACE reporting requirements will apply to transactions in Treasury bills, notes, bonds and inflation-protected securities (referred to as "TIPS"), as well as separate principal and interest components of a US Treasury security that have been separated pursuant to the Separate Trading of Registered Interest and Principal of Securities (STRIPS) program operated by the Treasury Department. (The *Corporate & Financial Weekly Digest* edition of July 22, 2016 summarized FINRA's proposed amendments.)

The amendments provide an exemption from TRACE reporting for purchases of a US Treasury security from the Treasury Department as part of an auction. However, "when-issued transactions"—which can take place after the Treasury Department's announcement of an auction but before the auction and issuance of the securities—are reportable under the new reporting requirements. The amendments also clarify that repurchase and reverse repurchase transactions are not reportable to TRACE.

FINRA also has adopted a new trade indicator for "when-issued transactions," as well as two new trade modifiers for package transactions involving US Treasury securities as follows: 1) a ".B" modifier, if the transaction being reported is part of a series of transactions where at least one of the transactions involves a futures contract; and 2) an ".S" modifier, if the transaction being reported is part of a series of transactions and may not be priced based on the current market.

The reporting requirements for US Treasury securities transactions will go into effect on July 10, 2017, with the exception of the use of the two new modifiers. FINRA has not adopted an implementation date for the new modifiers at this time. FINRA will not disseminate information on transactions in US Treasury securities and will not charge transaction-level fees on transactions in US Treasury securities reported to TRACE.

More information on FINRA Regulatory Notice 16-39 is available here.

DERIVATIVES

See "CFTC Addresses Application of MMF No-Action Letter" in the CFTC section and "SEC Approves FINRA's Capital Acquisition Broker Rules" in the Broker-Dealer section.

CFTC

CFTC Addresses Application of MMF No-Action Letter

On October 18, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (Division) released an interpretive advisory for futures commission merchants (FCMs) that addressed implementation of a recent no-action letter regarding investments in money market funds (MMFs).

Recent changes to Securities and Exchange Commission rules would have prohibited FCMs from investing customer funds in MMFs that invest primarily in corporate debt securities (Prime MMFs), or MMFs that invest primarily in US government securities and that voluntarily elect to be subject to liquidity fees or redemption restrictions (Electing Government MMFs). In CFTC Letter No. 16-68 (discussed in the August 12 edition of the *Corporate & Weekly Financial Digest*), the Division granted no-action relief permitting an FCM to invest the amount of funds held in segregated accounts, secured accounts and cleared swaps accounts in excess of the firm's targeted residual interest in Prime MMFs and Electing Government MMFs under certain conditions.

In the advisory, the Division explains that good-faith, inadvertent, over-investments beyond the residual interest target excess will not necessarily violate the no-action letter if the FCM acts promptly to: 1) move proprietary money into the segregated account; or 2) initiate liquidation of the Prime or Electing Government MMF to come into compliance. The Division also explains how asset-based and issuer-based concentration limits are applied.

The full advisory is available here.

CFTC Exempts Certain Southwest Power Pool Transactions

On October 18, the Commodity Futures Trading Commission approved a final order exempting certain transactions of Southwest Power Pool, Inc. (SPP) from the Commodity Exchange Act (CEA) and CFTC regulations. SPP is a Regional Transmission Organization (RTO) regulated by the Federal Energy Regulatory Commission.

The final order exempts SPP transmission congestion rights, energy transactions and operating reserve transactions from specified provisions of the CEA and CFTC regulations. Significantly, the transactions will be exempt from private actions under CEA section 22. The final order also amends an existing order exempting certain transactions of six other RTOs and independent system operators by exempting those transactions from section 22 private actions.

SPP is still subject to the CFTC's general anti-fraud and anti-manipulation authority and scienter-based prohibitions.

The final order is available here.

EU DEVELOPMENTS

ESMA Publishes Guidelines on Remuneration Practices Under UCITS and AIFMD

On October 14, the European Securities and Markets Authority (ESMA) published two sets of guidelines (Guidelines) on sound remuneration practices for EU managers of Undertakings for Collective Investment in Transferable Securities (UCITS) funds (UCITS Guidelines) and EU managers subject to the Alternative Investment Fund Manager (AIFM) Directive (AIFMD Amending Guidelines).

The AIFMD Amending Guidelines ameliorate existing AIFMD guidelines on sound remuneration policies published in July 2013. The amendments clarify the application of the Guidelines to AIFMs in a group context, and note that there should be "no exception" for AIFMs which are subsidiaries of a bank.

As mentioned in our previous update, the UCITS Guidelines apply to management companies and EU regulators, and set out guidelines: 1) on how to identify the categories of staff subject to the remuneration requirements; 2) for management companies part of a group; 3) on the application of sectoral rules; 4) on governance arrangements for remuneration (including management bodies, remuneration committees and control functions); 5) on risk alignment; and 6) on disclosure.

Next steps are for EU regulators to confirm whether they intend to comply with the Guidelines within two months. Both sets of Guidelines will go into effect on January 1, 2017.

For further information on the Guidelines, see the *Corporate & Financial Weekly Digest* edition of April 8, 2016.

The UCITS Guidelines are available here, and the AIFMD Amending Guidelines, here. ESMA's accompanying press release is available here.

ESMA Updates UCITS Q&A

On October 12, the European Securities and Markets Authority (ESMA) updated its Questions and Answers (Q&A) on the EU Undertakings for Collective Investment in Transferable Securities (UCITS) Directive. The changes include the addition of clarification: 1) that the term "regulated market in a member state" includes a multilateral trading facility (as defined by the Markets in Financial Instruments Directive); 2) that remuneration disclosure information does not need to be translated into the same languages as the UCITS fund's key investor information document; 3) on collateral management calculations in the context of UCITS rules limiting investments in units of other funds; and 4) disclosure requirements affecting UCITS introduced by the EU Securities Financing Transactions Regulation.

The updated Q&A is available here.

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

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