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SEC / CORPORATE

SEC Division of Corporation Finance Issues C&DIs on Exempt Offerings Under Rule 701 and Sales of Securities Under Rule 144(d)

On October 19, the staff of the Division of Corporation Finance of the Securities and Exchange Commission (the Staff) issued one new Compliance and Disclosure Interpretation (C&DI) and two revised C&DIs. Revised C&DI 271.04 and new C&DI 271.24 relate to exempt offerings and sales of securities under Rule 701 of the Securities Act of 1933 (the Securities Act), while revised C&DI 532.06 addresses the holding period for restricted securities under Rule 144(d).

Revised C&DI 271.04

In the original C&DI 271.04, issued in January 2009, the Staff indicated, without further explanation, that, when a company that is not subject to Section 13 or Section 15(d) (a non-reporting company) reporting requirements pursuant to the Securities Exchange Act of 1934 (the Exchange Act) is acquired by a reporting company, and options issued by the non-reporting company in reliance on Rule 701 are assumed by the reporting company and converted into options to acquire shares of the reporting company, the reporting company does not need to register the offer and sale of the shares issuable upon the exercise of such options. In the revised C&DI 271.04, the Staff clarified the reasoning behind its interpretation by analogizing to Rule 701(b)(2), which permits an issuer to rely on Rule 701 to sell securities offered prior to the issuer's becoming a reporting company. In this revised C&DI, the Staff notes that the reporting company that acquires the non-reporting company may similarly rely on the exemption from registration provided in Rule 701 for the exercise of the assumed options. The Staff also noted that the reporting company's reports under the Exchange Act will satisfy any disclosure required under Rule 701(e).

New C&DI 271.24

New C&DI 271.24 addresses the offer and sale of a restricted stock unit (RSU) award under Rule 701 to an employee and the timing requirements for delivery of additional information specified in paragraphs (1) through (4) of Rule 701(e) if the issuer, during a 12-month period, sells an aggregate amount of securities (including the restricted securities) in excess of $5 million. The Staff's interpretation indicates that, in such a circumstance, the issuer must deliver such information to investors within "a reasonable period of time before the date of the sale" of securities. The date of sale of the RSU award, for purposes of Rule 701, is the date the award is made. Consequently, the issuer must provide the additional information to investors within a reasonable period of time before the RSU award is made. The Staff also noted that, despite the fact that RSUs are typically considered derivative securities, Item 701(e)(6), which relates to the exercise or conversion of derivative securities, does not apply because the restricted securities are not exercised or converted.

Revised C&DI 532.06

In the original C&DI 532.06, issued in January 2009, the Staff stated that, "where restricted securities are issued to an employee in connection with an individually negotiated employment agreement," the holding period under Rule 144(d) with respect to such restricted securities begins to run at the time such employee's securities vest, assuming any conditions have been fulfilled. The Staff has now supplemented its prior guidance. In the revised C&DI 532.06, the Staff indicated that the holding period under Rule 144(d) under these circumstances begins

when the recipient of such restricted securities is deemed to have paid for and assumed the full risk of economic loss with respect thereto. The Staff further explained that the economic loss associated with the securities passes to the employee:

- for awards that require additional payment upon the exercise, conversion or settlement of the award, on the date when such additional payment is made; and
- for full-value awards that do not require further consideration and vest based solely on the employee's (a) continued employment with the issuer; and/or (b) satisfaction of performance metrics that are not individual performance metrics, on the date when the employment agreement becomes effective.

The complete text of the new and revised C&DIs is available here, here and here.

BROKER-DEALER

SEC Approves Amendments to Rules Governing Communications With the Public

On October 26, the Financial Industry Regulatory Authority announced that the Securities and Exchange Commission approved amendments to the FINRA rules governing communications with the public. The amendments revise the filing requirements in FINRA Rule 2210 (Communications with the Public) and Rule 2214 (Requirements for the Use of Investment Analysis Tools) and the content and disclosure requirements in Rule 2213 (Requirements for the Use of Bond Mutual Fund Volatility Ratings). The amended rules will go into effect on January 9, 2017.

Currently, Rule 2210 requires firms to file with FINRA retail communications that contain registered investment company performance information and a copy of any investment company rankings and comparisons included in the retail communications. Under the amended rule, firms will no longer be required to file ranking and comparison backup materials. Additionally, retail communications containing generic investment company information (e.g., materials that do not name specific funds or fund families) will no longer need to be filed with FINRA.

FINRA also has eliminated or reduced filing requirements relating to investment company shareholder reports, investment analysis tool written report templates, and non- predictive updates to narratives in retail communication filings.

Finally, FINRA amended provisions of Rule 2213 relating to bond mutual fund volatility ratings.

FINRA Regulatory Notice 16-41 is available here.

SEC Chair Discusses Treasury Market Reform

On October 24, Securities and Exchange Commission Chair Mary Jo White gave a keynote address titled "Prioritizing Regulatory Enhancements for the US Treasury Market" at the second annual conference, "The Evolving Structure of the US Treasury Market," in New York. Among other remarks, Chair White discussed the following topics:

- beginning in July 2017, Financial Industry Regulatory Authority members will be required to report transactions in US Treasury securities through TRACE, a system providing regulators (but not the public) with Treasury trade information. However, Chair White stated she is interested in pursuing public transparency for Treasury trades. Similarly, the Federal Reserve Board intends to collect US Treasury securities transactions data from banks. Chair White has directed the SEC staff to develop recommendations regarding the application of Reg ATS and Reg SCI to broker-dealer sponsored platforms trading government securities;
- active principal trading firms operating in the equities or US Treasury markets give "rise to the question of whether those firms are acting as dealers and [are] registered as such;"
- as mentioned in a prior speech Chair White delivered in September, SEC staff will soon publish its work on disruptive trading practices in the equities markets for the public's full consideration. The staff's work could lead to the creation of an anti-disruptive trading rule; and
- in response to a request from the director of the Division of Trading and Markets, FINRA is reviewing its

rules to determine which rules should apply to US Treasuries. FINRA staff has plans to propose application of certain conduct rules to government securities.

The full text of the speech is available here.

EU DEVELOPMENTS

ESMA Publishes MAR Guidelines on Receiving Market Soundings

On October 20, the European Securities and Markets Authority (ESMA) published guidelines (Guidelines) on receiving market soundings (also commonly known as being "wall crossed,") under the EU Market Abuse Regulation (MAR). The Guidelines apply to EU regulators and persons receiving a market sounding (MSR) wherever in the world they are located. They seek to ensure consistent and uniform approaches on the factors, steps and records MSRs are required to implement under MAR. The Guidelines are divided into six sections covering: 1) internal procedures and staff training; 2) notifications when MSRs do not want to receive future market soundings; 3) assessments of possession and ceasing to possess inside information as a result of a market sounding; 4) assessments of related financial instruments; 5) written minutes or notes; and 6) record keeping.

Internal Procedures and Staff Training

The Guidelines specify that MSRs should implement internal procedures and staff training to ensure that: 1) the market participant who is disclosing a market sounding (DMP) is made aware of the MSR's designated contact point for receiving market soundings; 2) information received as part of market sounding is communicated on a "need-to-know" basis internally, through predetermined reporting channels; 3) the persons responsible for assessing whether an MSR is in possession of inside information are properly trained; and 4) the flow of inside information is managed and controlled. The Guidelines state that staff receiving and processing inside information from a market sounding must be trained on the MSR's procedures, and also on the MAR prohibitions on insider dealing and unlawful disclosure of inside information.

Notifications to DMPs on Future Market Soundings

The Guidelines state that MSRs should notify DMPs that have contacted them if they do not want to receive other market soundings (in respect of all future transactions or certain types).

Assessments on Possession and Ceasing To Possess Inside Information

When independently assessing whether an MSR is: 1) in possession of inside information; and/or 2) no longer in possession of inside information, the Guidelines clarify that MSRs should consider all information available to them (including the DMP's assessment, and from other sources). The Guidelines also state that the individual, function or body responsible for making those assessments assessment must not be required to breach information barriers established by the MSR.

Assessments of Related Financial Instruments

Where a MSR determines it is in possession of inside information as a result of a market sounding, the Guidelines state that the MSR also should identify all issuers and financial instruments that the inside information relates to.

Written Minutes or Notes

The Guidelines state that MSR's should reconcile their internal minutes or notes of unrecorded meetings and or unrecorded phone conversations with those of the DMP. The Guidelines state that on receipt of the DMP's internal minutes or notes, MSR's should either 1) sign those minutes or notes to indicate their agreement; or 2) provide signed versions of their own minutes or notes where they do not agree with the DMP's content.

Record Keeping

The Guidelines state that MSR's should to keep records of: 1) internal market sounding procedures; 2) notifications to DMPs on future market soundings; 3) assessments of possession and ceasing to possess inside information; and 4) assessments of related financial instruments; and 5) contractors and employees with access to information communicated during a market sounding (listed in chronological order for each sounding), in a durable, accessible and readable form, for at least five years.

Next steps are for EU regulators to confirm whether they intend to comply with the Guidelines. The Guidelines otherwise will go into effect on December 20, 2016.

The Guidelines can be found here.

ESMA Publishes MAR Guidelines for EU-Listed Issuers on Delaying Disclosure of Inside Information

On October 20, the European Securities and Markets Authority (ESMA) published guidelines (Guidelines) on the scope of circumstances where an EU-listed issuer may delay disclosure of inside information, under the EU Market Abuse Regulation (MAR). The Guidelines apply to EU regulators and issuers of financial instruments admitted to trading on an EU trading venue (EU regulated market, EU multilateral trading facility (MTF) or organized trading facility (OTF)) and aim to guide such issuers when deliberating whether to delay the disclosure of inside information, in accordance with Article 17(4) of MAR.

Article 17 of MAR requires an issuer of EU financial instruments to disclose to the public inside information related to that issuer as soon as possible, unless: 1) the immediate disclosure is likely to prejudice the legitimate interests of the issuer; 2) delaying disclosure is not likely to mislead the public; and 3) the issuer is able to ensure the information remains confidential.

The latest Guidelines provide examples of "legitimate interests" of issuers that are likely to be jeopardized by the immediate disclosure of inside information. These include:

- negotiations (for mergers, acquisitions, splits and spin-offs, purchasers or disposals of major assets or restructures) where the outcome would likely be jeopardized;
- when the financial viability of the issuer is in "grave and imminent danger" (but not insolvent), and disclosure would seriously prejudice the interests of shareholders by jeopardizing negotiations to ensure the issuer's financial recovery;
- when the inside information relates to decisions or contracts entered into by an issuer's management body, which need (under national laws or the issuer's bylaws) the approval of another body of the issuer (other than the shareholders' general assembly). This situation applies when: 1) immediate public disclosure before a final decision would jeopardize the correct assessment of the information by the public; and 2) the issuer has arranged for the final decision to be made as soon as possible;
- when disclosure is likely to jeopardize the intellectual property rights of an issuer with respect to a product or invention;
- when the issuer is planning to buy or sell a major holding in another entity and disclosure would likely jeopardize that plan; or
- when 1) an issuer has announced a transaction or deal; 2) the deal is subject to a public authority's approval on condition of meeting certain requirements; and 3) disclosing those requirements would likely affect the ability of the issuer to fulfil those requirements (and therefore prevent the success of the deal or transaction itself).

The Guidelines also detail situations where delaying disclosure of inside information would be likely to mislead the public. These situations include when the inside information:

- is materially different from a relating previous public announcement of the issuer;
- concerns the issuer's inability to meet its financial objectives, where such objectives were previously publicly announced; or
- is different from the market's expectations, based on signals or information previously sent to the market by the issuer (such as through interviews, roadshows or any other communications).

Next steps are for regulators to confirm whether they intend to comply with the Guidelines within two months. The Guidelines otherwise will go into effect on December 20, 2016.

The Guidelines can be found here.

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

For more information, contact:

SEC/CORPORATE		
Mark J. Reyes	+1.312.902.5612	mark.reyes@kattenlaw.com
Mark D. Wood	+1.312.902.5493	mark.wood@kattenlaw.com
FINANCIAL SERVICES		
Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
James Van De Graaff	+1.312.902.5227	james.vandegraaff@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com
EU DEVELOPMENTS		
Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk

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