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## SEC/CORPORATE

### Supreme Court Rules on Insider Trading Involving Family and Friends

In its first insider trading decision in nearly two decades, the US Supreme Court ruled unanimously to uphold an insider trading conviction of an individual (tippee) who traded while aware of material non-public information (MNPI) received from a friend (tipper) who did not receive a financial benefit for providing the tip. *Salman v. United States*, No. 15-628, 2016 WL 7078448 (U.S. Dec. 6, 2016). The ruling, written by Justice Samuel Alito, settles a split of authority between the US Court of Appeals for the Second and Ninth Circuits regarding whether a tipper receives a "personal benefit" for purposes of establishing insider trading liability by simply conveying MNPI to a family member or friend.

The defendant in the case, Bassam Salman, had been convicted for trading on MNPI regarding pending mergers and acquisitions he learned from his friend, Michael Kara. Mr. Kara was tipped off by his brother, Maher Kara, an investment banker and also Mr. Salman's future brother-in-law. Mr. Salman had argued that he was wrongfully convicted because Mr. Maher did not receive money or anything else of tangible value for passing along the MNPI. In doing so, Mr. Salman had relied upon the Second Circuit's landmark *Newman* decision, which held that a personal benefit may not be inferred from a personal relationship between the tipper and tippee, absent "proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential and represents at least a potential gain of a pecuniary or similarly valuable nature." *United States v. Newman*, 773 F.3d 438, 452 (2d Cir. 2014). The Second Circuit determined that such a finding "requires evidence of 'a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the [latter].'" *Id.* The Ninth Circuit, in upholding Mr. Salman's jury conviction, had rejected the Second Circuit's position, finding that the unlawful insider trading element of breach of fiduciary duty is met where an "insider makes a gift of confidential information to a trading relative or friend," as stated by the Court in its 1983 decision in *Dirks v. SEC*. 463 U.S. 646, 664 (1983).

In its *Salman* opinion, the Court agreed with the Ninth Circuit and reiterated the position it established in *Dirks*. The Court stated that *Dirks* is clear—a breach of fiduciary duty occurs when a tipper discloses information for a personal benefit and a personal benefit may be inferred where confidential information is gifted to a "trading relative or friend." According to the Court, Mr. Maher disclosed MNPI to Mr. Kara with the expectation that he would trade on it, and Mr. Kara shared the information with Mr. Salman, who knew that the information had been improperly disclosed. Mr. Salman assumed Mr. Maher's fiduciary duties and breached those duties when he traded on the information. The Court rejected the *Newman* test in holding that the government need not show that tippers received a concrete benefit for their tips if they are giving information to a relative or friend. "Making a gift of inside information to a relative . . . is little different from trading on the information, obtaining the profits and doling them out to the trading relative. The tipper benefits either way," stated Justice Alito.

Clearly, the *Salman* holding will lower the evidentiary burden on the Government to prosecute insider trading cases involving friends or relatives. With this in mind, corporate compliance personnel should re-emphasize to insiders that they must remain vigilant in safeguarding MNPI in their communications with friends and family members.

### Director of SEC Division of Corporation Finance, Keith Higgins, To Leave SEC

On December 6, the Securities and Exchange Commission announced that Keith F. Higgins, director of the Division of Corporation Finance (Division), plans to depart the SEC in early January 2017. Among Mr. Higgins' many accomplishments, as noted in the SEC's press release, Mr. Higgins led the SEC's implementation of significant rulemaking under the Dodd-Frank Wall Street Reform and Consumer Protection Act, Jumpstart Our Business Startups Act (JOBS Act) and Fixing America's Surface Transportation Act (FAST Act), and directed the Division's disclosure effectiveness initiative, undertaking a comprehensive review of the SEC's disclosure requirements. Upon his departure, Shelley Parratt, deputy director of the Division, will become the acting director.

The SEC's press release is available here.

## BROKER-DEALER

### FINRA Interprets "As Soon As Practicable" Requirement Under Trade Reporting Rules

The Financial Industry Regulatory Authority has issued a notice clarifying the "as soon as practicable" requirement under FINRA reporting rules for transactions effected over-the-counter (OTC). As background, FINRA rules provide that OTC trades in national market system (NMS) securities that are executed during the hours that a FINRA trade reporting facility is open must be reported for dissemination purposes as soon as practicable, but no later than 10 seconds, following trade execution.

As set forth in the notice, FINRA interprets the "as soon as practicable" requirement to prohibit a firm from releasing information relating to OTC transactions in NMS securities to other market participants any sooner than the firm releases such information to a FINRA trade reporting facility for dissemination (or "tape") purposes.

FINRA's notice is available here.

## DERIVATIVES

*See "CFTC Re-Proposes Minimum Capital Requirements for Swap Dealers and Major Swap Participants," "CFTC Finalizes Aggregation Rules and Re-Proposes Position Limits Rule" and "CFTC Releases Results of ICE Futures U.S. Rule Enforcement Review" in the CFTC section.*

## CFTC

### CFTC Re-Proposes Minimum Capital Requirements for Swap Dealers and Major Swap Participants

On December 2, the Commodity Futures Trading Commission re-proposed minimum capital requirements for swap dealers (SDs) and major swap participants (MSPs) that are not subject to prudential regulation (Covered Entities). The CFTC had initially proposed capital rules for Covered Entities in 2011 but deferred further action pending finalization and implementation of uncleared swaps margin requirements. The CFTC finalized margin requirements in December 2015 that began being implemented in September 2016.

Under the CFTC's proposal, there would be three alternative capital approaches: a bank-based capital approach, a net liquid assets capital approach and a tangible net worth capital approach for SDs. The bank-based capital approach would permit SDs to comply with capital requirements adopted by the Board of Governors of the Federal Reserve System for bank holding companies.

The net liquid assets capital approach would be consistent with the CFTC's current capital requirements for future commission merchants, the Securities and Exchange Commission's current capital approach for broker-dealers and over-the-counter derivatives dealers, and the SEC's proposed requirements for security-based swaps dealers. Under this approach, an SD would be required to maintain a minimum level of adjusted net capital (i.e., relatively liquid capital) of at least the greater of US $20 million; 8 percent of margin required on the SD's cleared and uncleared swaps, security-based swaps and futures and foreign futures positions; or the amount of capital

required by the National Futures Association. A joint FCM and SD that is also a BD would have to meet the higher of these three tests or the requirements of the SEC for a BD.

Finally, an SD principally engaged in non-financial activities could maintain tangible net worth adjusted to exclude certain intangible assets (e.g., goodwill) of at least the greater of US $20 million adjusted by market and credit risk charges on certain of its proprietary swaps positions; 8 percent of margin required on the SD's cleared and uncleared swaps, security-based swaps and futures and foreign futures positions; or the amount of capital required by NFA.

Non-US-based SDs could potentially comply with local capital requirements as an additional alternative if approved by the CFTC pursuant to a comparability determination.

As part of its proposed capital rules, the CFTC would also require Covered Entities to provide it and NFA with monthly financial statements and an annual certified financial statement and to keep current books and records. Covered entities would also be subject to special early warning notification requirements related to material adverse changes in their financial condition, as well as an obligation to report weekly their uncleared swaps position and margin information "for the purposes of conducting risk surveillance." These reports appear to be in addition to the current requirements for SDs to file daily large trader reports with the CFTC for reportable positions in physical commodity swaps and transaction information for all over-the-counter swaps data repositories.

SDs that choose to rely on the bank-based or net liquid assets capital approaches would additionally be subject to certain liquidity requirements, including performing monthly stress tests if relying on the liquid assets capital option.

The CFTC re-proposed capital rules are available here.

### CFTC Finalizes Aggregation Rules and Re-Proposes Position Limits Rule

On December 5, the Commodity Futures Trading Commission voted to repropose position limits for futures and swap positions. On the same day, the CFTC also approved final aggregation rules for futures and option contracts on nine agricultural commodities.

Aggregation Rules

With minor modifications, the final aggregation rules follow the proposed rules that were published for comment in September 2015. Among other provisions, the rules provide that an entity owning 10 percent or more of another entity will be required to aggregate the owned entity's positions, unless the entity meets the requirements for an exemption set out in the rules and files a timely claim for an exemption with the CFTC. The rule does not grandfather entities that are currently disaggregating positions. Therefore, it would appear that such entities will be required to file a claim for an exemption by the effective date of the rules, i.e., 60 days following publication in the *Federal Register*.

Designated contract markets (DCMs) and swap execution facilities (SEFs) will be required to conform their aggregation policies to the CFTC aggregation rules.

Position Limits

After proposing position limits in 2013 and releasing a supplemental proposal in June of 2016, the CFTC re-proposed position limits for 25 core physical commodity futures contracts and their economically equivalent futures, options and swaps (referenced contracts). The re-proposal does not address three cash-settled contracts (Class III Milk, Feeder Cattle, and Lean Hogs) initially included in the 2013 proposal.

The re-proposal contains exemptions for bona fide hedging (as newly defined) and exchange recognition of non-enumerated bona fide hedging positions, certain anticipatory hedge positions, and spread exemptions. The re-proposal also specifies acceptable practices for DCMs and SEFs to set position limits for the referenced contracts. As currently proposed, DCMs and SEFs without access to position information on swaps would be temporarily relieved from the obligation to establish position limits.

Finally, the re-proposal contains revised reporting requirements under CFTC regulations.

The CFTC press release announcing the final aggregation rules and the reproposed position limits is available here.

### CFTC Releases Results of ICE Futures U.S. Rule Enforcement Review

On December 7, the Commodity Futures Trading Commission's Division of Market Oversight (DMO) announced the results of its rule enforcement review of ICE Futures U.S. The review covered a one-year target period and evaluated ICE's compliance with Designated Contract Core Principles 2 (Compliance With Rules) and 12 (Protection of Markets and Market Participants).

Based on its review, DMO determined that ICE has an adequate trade practice surveillance program subject to a series of recommendations with respect to ICE's proactive reviews of trade practice violations, automated trade surveillance system and trade practice investigations. However, DMO determined that ICE was deficient in meeting its obligations under CFTC regulation 38.158(b), which requires a designated contract market to complete investigations in one year or less, absent mitigating circumstances.

A copy of the results is available here.

A copy of the release is available here.

## UK/BREXIT DEVELOPMENTS

### FCA Publishes Updated Page on MiFID II Legal Entity Identifiers

On December 2, the UK Financial Conduct Authority (FCA) updated its website on the revised Markets in Financial Instruments Directive (MiFID II) to include a new section on transaction reporting and legal entity identifiers (LEI Update) under MiFID II. The LEI Update sets out the function and purpose of an LEI, and clarifies that from January 3, 2018, firms subject to MiFID II transaction reporting will be unable to execute trades in financial instruments on behalf of clients that are eligible for an LEI, but who do not have an LEI. The LEI Update details how to obtain an LEI and also reminds firms that LEIs must be renewed on an annual basis.

The LEI Update can be found here.

### UK Supreme Court Hears UK Government's Article 50 Brexit Case Appeal

Between December 5 and 8, the UK Supreme Court heard an appeal (Appeal) from the UK government (Government) with respect to *R (on the application of Miller & Dos Santos) v Secretary of State for Exiting the European Union*.

The Appeal relates to the UK High Court's decision on November 3, that the Government does not have requisite prerogative powers necessary to give notice under Article 50 for the United Kingdom to withdraw from the European Union, and instead an Act of Parliament is required (see the *Corporate & Financial Weekly Digest* edition from November 3). Following that ruling, the UK Supreme Court granted permission for the Government to appeal the High Court's decision and subsequently granted rights to intervene to certain applicants, including the Scottish Government and Welsh Government, among others. On November 25, the Government's case (Case) was made available online.

The Case maintains that: (1) the exercise of the Government's prerogative powers is sufficient to give notice pursuant to Article 50; (2) the Government's prerogative powers, including powers to make, amend and or withdraw from treaties, is constitutionally "normal" and consistent with the UK's dualist approach to international law; (3) the UK Parliament, through the European Communities Act 1972 (ECA), the EU Referendum Act 2015 and other EU-related legal instruments in UK domestic law, has not expressly or impliedly removed the Government's prerogative powers in the fields of foreign affairs and treaties; and (4) a "surprising" consequence of the High Court's decision is that the UK Parliament will be asked the same question put by the UK Parliament to the electorate (i.e., whether the UK should remain a member of the EU), and will be obliged to give the same answer as the electorate in legislative form.

Transcripts published of the Appeal indicate that on the first day of the hearing, several members of the UK Supreme Court questioned the Government's argument that it has unfettered powers to affect rights of British persons at the EU level through the unilateral exercise of prerogative powers by ministers. The Lord Justices noted that entering into the EU was a joint effort between the UK Parliament and Government, and that the Government would need to address whether departing the EU should also be a joint effort. On the second day of the hearing, the Government confirmed that, should it lose the Appeal, its proposed solution will be a "one-line" Act of Parliament authorizing submission of the Article 50 notice, with no further details on the withdrawal agreement or how the Government might negotiate with the EU. The Government further argued that devolved legislation does not qualify the foreign affairs prerogative.

On the third day of the hearing, respondents to the Appeal (including Gina Miller, Dos Santos and others), argued that the UK referendum did not have binding legal effect, or at least not to the extent of limiting parliamentary sovereignty. The respondents further argued that the prerogative power to make and/or withdraw from treaties does not allow ministers to quash statutory rights and duties, and that the ECA has a "constitutional status" that cannot be set aside by ministers acting without parliamentary assent. Submissions also were heard from the intervening Scottish Government, and Northern Ireland, who argued that formal consultation with, and consent from, the devolved assemblies would be required for the UK to withdraw from the EU. The Welsh Government made submissions on the fourth day of the hearing, which concluded with the Government's rebuttal.

On the third day of the Appeal, the UK House of Commons passed a motion in support of the Government's plan to invoke Article 50 by March 31, 2017. The legal effect of the motion, including any impacts on the Appeal, is unclear, although the Government's counsel appeared to concede it was non-binding.

The UK Supreme Court expects to publish its decision in early 2017, and plans to issue an alert in advance of publication.

For more information on the Appeal, see the *Corporate and Financial Weekly Digest edition of* December 2.

Transcripts of the Appeal, an agenda of proceedings and copies of the written arguments of the parties (including the Case) are available here.

The motion 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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