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DERIVATIVES

Banking Regulators Propose Basel III Capital Rules

On June 7, the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation jointly proposed new capital rules to implement the Basel III international regulatory capital reforms mandated by the Basel Committee on Banking Supervision. These proposals, which will be open for comment for 90 days, will apply to all depository institutions, bank holding companies with total consolidated assets of $500 million or more, and savings and loan holding companies. Among many things, the proposals raise the minimum tier 1 capital ratio from 4% to 6% of risk-weighted assets and introduces a new tier 1 common equity ratio and a capital conservation buffer.

Further information about the 871 page proposal can be found here.

CFTC

NFA Reminds Members of BSA Electronic Filing Requirements

On June 5, the National Futures Association issued a notice reminding members that, beginning July 1, all Bank Secrecy Act (BSA) reports must be filed electronically. On February 29, the Financial Crimes Enforcement Network (FinCen) published a final notice that requires all financial institutions subject to the BSA, including futures commission merchants (FCMs) and introducing brokers (IBs), to file BSA reports electronically. As a result, beginning July 1, FCMs must file Suspicious Activity Reports (SARs) and Currency Transaction Reports electronically and IBs must file SARs electronically through FinCEN's BSA E-Filing System. FCMs and IBs that have not enrolled in the BSA E-Filing System should begin the enrollment process, which can take 5 to 7 days, as soon as possible.

The NFA's notice to members is available here.
Enrollment information for FCMs and IBs is available here.

IOSCO Publishes Final Derivatives Market Intermediary Report

On June 6, the International Organization of Securities Commissions (IOSCO) published a report on International Standards for Derivatives Market Intermediary Regulation. The report includes high level recommendations for international regulatory standards for market participants that deal, intermediate, or make markets in over-the-counter (OTC) derivatives. The recommendations in the report are intended to address: (i) derivatives market intermediary (DMI) obligations that should help mitigate systemic risks; (ii) management of counterparty risk in OTC derivative markets; and (iii) protection of OTC participants from unfair, improper or fraudulent practices. The report also makes recommendations regarding registration and licensing standards, capital standards or financial resource requirements for DMIs, business conduct standards, supervision standards and recordkeeping standards.

A copy of the IOSCO report is available here.

LITIGATION

Delaware Court of Chancery Allows Depositions of Foreign Witnesses to Establish Personal Jurisdiction

The Delaware Court of Chancery recently addressed the extent to which a plaintiff may depose witnesses for the purpose of establishing personal jurisdiction under a conspiracy theory.

Plaintiff Dennis A. Reid sued Alenia Spazio, Alcatel Alenia Space Italia, S.p.A, and Finmeccanica S.p.A. alleging that defendants conspired to divest U.S. Russian Telecommunications, LLC of its interest in a business venture intended to exploit, for commercial gain, satellite orbital slots controlled by Russia.

The defendants moved to dismiss on the grounds that the Delaware Chancery Court did not have personal jurisdiction. The plaintiff sought to depose several out-of-state witness as part of jurisdictional discovery. The defendants objected on the grounds that: 1) the depositions were cumulative or duplicative of prior discovery, 2) the plaintiff improperly delayed in seeking the requested depositions, and 3) the depositions would be unduly burdensome or expensive.

The Court noted that plaintiffs are generally entitled to reasonable discovery for the purpose of establishing personal jurisdiction and rejected all the defendants' arguments against the depositions. First, the Court rejected the defendants' argument that discovery would be cumulative or duplicative, because prior discovery in the case had not sufficiently addressed the personal jurisdiction issue, Second, the Court held that the plaintiff sought the proposed depositions within a reasonable period after receiving documents and responses to interrogatories. Third, while the Court acknowledged the costs of potentially deposing international witnesses in Italy, France and Russia, it held that the defendants were aware of the international expense and obstacles when they entered into the disputed transaction.

The Court concluded that the plaintiff had alleged sufficient facts to establish that the depositions would be relevant to or reasonably calculated to lead to relevant evidence on the issue of personal jurisdiction.

Reid v. Siniscalchi, No. 2874-VCN (Del. Ch. May 25, 2012).

Delaware Chancery Court Grants Reformation of Contract to Reflect Prior Email Agreement

Vice Chancellor Laster of the Delaware Court of Chancery ordered reformation of a joint venture agreement where plaintiff ASB Allegiance Real Estate Fund (ASB) proved at trial, by clear and convincing evidence, that the compensation terms agreed to with defendant Scion Breckenridge Managing Member, LLC (Scion) were not accurately reflected in the parties' final executed contract.

ASB and Scion (through various affiliates) entered into real estate join ventures involving student housing projects. In general, ASB provided the majority of the capital and Scion managed the projects on a day-to-day basis. The parties agreed that Scion would be compensated in part through "promoted interest" or, in industry jargon, a "promote" (a portion of the cash flows generated by a capital event such as a sale or refinancing of the joint venture property).

According to the Court, the parties agreed in an email exchange that Scion would be entitled to a promote if the transaction resulted in a profit to the joint venture. The contract at issue, however, was written in a way that arguably required ASB to pay a promote to Scion even where the property was sold at a loss. ASB sued to reform the agreement.

Under Delaware law, the Court of Chancery can reform a contract to reflect the "real agreement" of the parties. The Court may choose to reform a contract in the case of a unilateral mistake, where one party is mistaken about a contract provision and the other party is aware of the mistake and stays silent. In order to obtain reformation of a contract, a plaintiff must demonstrate, by clear and convincing evidence, that a "specific prior understanding" of the contract is materially different from the written contract.

Based on fact and expert witness testimony, the Court found that ASB had established the requirements for reformation: (i) the email communications between ASB and Scion reflected an agreement on the promote clause that differed from the one set forth in the final written contracts; (ii) ASB mistakenly believed that the "promote"

clause in the final contracts was identical to terms contained in the prior emails; and (iii) Scion knew of ASB's mistaken belief and knowingly stayed silent so that Scion could receive the benefit of the erroneously drafted clause.

ASB Allegiance Real Estate Fund v. Scion Breckinridge Managing Member, LLC, No. 5843-VCL (Del. Ch. May 16, 2012).

BANKING

Regulators Issue Memorandum of Understanding

Five federal supervisory agencies, including the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, the National Credit Union Administration (Prudential Regulators), and the Consumer Financial Protection Bureau (CFPB or Bureau) on June 4 released a Memorandum of Understanding (MOU) dated May 16 that clarifies how the agencies will coordinate their supervisory activities pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). Section 1025(e)(1) requires that the CFPB and the Prudential Regulators: (1) coordinate the scheduling of examinations of Covered Institutions (generally, institutions with $10 billion or more in assets, and affiliates of such institutions) (2) conduct simultaneous examinations of insured depository institutions with more than $10 billion in assets and their insured depository institution affiliates unless the institution requests separate examinations; (3) share draft reports of examinations of Covered Institutions with the other regulatory agency and permit such at least 30 days to comment on the draft report before it is made final; and (4) take into consideration any concerns raised by the other regulatory agency before issuing the final report of examination.

The total assets of an insured depository institution are measured in accordance with the Supervisory Statement: Determination of Depository Institution and Credit Union Asset Size for Purposes of Sections 1025 and 1026 of the Dodd-Frank Act, issued by the Prudential Regulators and the CFPB (the Agencies) on November 17, 2011.

The Agencies will notify each other, as applicable, before engaging in a supervisory action or examination with respect to a subsidiary of an institution the accounts of which are insured by the FDIC (Nondepository Subsidiary). If the CFPB notifies the Prudential Regulator that it will examine or take supervisory or enforcement action relating to Federal consumer financial laws against any Nondepository Subsidiary, the Prudential Regulator will defer to the CFPB on matters relating to supervision or enforcement of the Federal consumer financial laws. The CFPB and the Federal Reserve Board plan to separately memorialize their arrangements to coordinate supervisory activities related to holding companies and their subsidiaries.

The MOU requires the Agencies to establish arrangements for coordination and cooperation between the CFPB and the Prudential Regulators, minimize unnecessary regulatory burden, avoid unnecessary duplication of effort, and decrease the risk of conflicting supervisory directives. This MOU, however, "is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or in equity by any party against the CFPB or the Prudential Regulators, nor does it limit or modify in any way the CFPB's or any Prudential Regulator's authority to engage in, or bring, supervisory, enforcement, or other actions, under applicable laws or to interpret those laws."

Under the MOU, the Agencies will coordinate examinations and other supervisory activities and share certain material supervisory information concerning:

- Compliance with federal consumer financial laws and certain other federal laws that regulate consumer financial products and services;
- Consumer compliance risk management programs;
- Activities such as underwriting, sales, marketing, servicing, collections, if they are related to consumer financial products or services; and
- Other related matters that the agencies may mutually agree upon.

According to the Agencies, "[t]hese coordination undertakings should lead to greater uniformity and efficiencies in supervision and help to minimize regulatory burden on covered depository institutions." The CFPB has previously entered into memoranda of understanding with the Conference of State Bank Supervisors and the Federal Trade Commission.

For more information, click here.

CFPB Seeks Further Comment on Ability-to-Repay Mortgage Rule

On May 31, the Consumer Financial Protection Bureau (CFPB or Bureau) announced that it is seeking public comment on new data and information that it has received in a rulemaking to require lenders to assess consumers' ability to repay mortgage loans before extending them credit. The comment period will close on July 9.

Sections 1411, 1412, and 1414 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) created new Truth in Lending Act (TILA) section 129C, which, among other things, establishes new ability-to-pay requirements and provides a presumption of compliance with those requirements if the mortgage loan is a "qualified mortgage." On May 11, 2011, the Board of Governors of the Federal Reserve System (Board) published for notice and comment a proposed rule amending Regulation Z (Truth in Lending) to implement amendments to the TILA made by the Dodd-Frank Act. The proposed rule addressed new ability-to-repay requirements that generally will apply to consumer credit transactions secured by a dwelling and the definition of a "qualified mortgage." Among other consumer financial protection laws, the Dodd-Frank Act transferred the Board's rulemaking authority for TILA to the Bureau as of July 21, 2011. The original comment period to the proposed rule closed on July 22, 2011. The Bureau is reopening the comment period until July 9, to seek comment specifically on certain new data and information submitted during or obtained after the close of the original comment period. As the Bureau explained, "Through various comment letters, ex parte communications, and the Bureau's own collection of data, the Bureau has received additional information and new data pertaining to the proposed rule. The Bureau is interested in providing opportunity for additional public comment on these materials." The Bureau also made it clear that it "is not soliciting comment on other aspects of the proposed rule. Therefore, the Bureau encourages commenters to limit their submissions accordingly."

Specifically, the "Bureau seeks comment on mortgage loan data that the Bureau has received from the Federal Housing Finance Agency (FHFA). To date, the Bureau has received a sample drawn from the FHFA's Historical Loan Performance (HLP) dataset along with tabulations from the entire file. The data include a one percent random sample of all mortgage loans in the HLP dataset from 1997 through 2011; and tabulations of the HLP dataset by FHFA showing the number of loans and performance of those loans by year and debt-to-income (DTI) range."

It is unclear whether the Bureau reopened the comment period out of necessity in light of the ex parte communications it received. For more information, click here.

CFPB Issues Final Rules Relating to Investigations, Adjudicative Proceedings, and Notifications of Actions by State Officials

Investigations

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) transferred to the Consumer Financial Protection Bureau (Bureau) the consumer financial protection functions formerly carried out by the Federal banking agencies, as well as certain authorities formerly carried out by the Department of Housing and Urban Development (HUD) and the Federal Trade Commission (FTC). The Dodd-Frank Act authorizes the Bureau to conduct investigations to ascertain whether any person is or has been engaged in conduct that, if proved, would constitute a violation of any provision of Federal consumer financial law. Section 1052 of the Dodd-Frank Act sets forth the parameters that govern these investigations. Section 1052 became effective immediately upon transfer on July 21, 2011 and did not require rules to implement its provisions. On July 28, 2011, the Bureau issued the interim final rule for the Rules Relating to Investigations (Interim Final Rule) to provide parties involved in Bureau investigations with clarification on how to comply with the statutory requirements relating to Bureau investigations. Consistent with Section 1052 of the Dodd-Frank Act, the final rule for the Rules Relating to Investigations (Final Rule Investigations) describes a number of Bureau policies and procedures that apply in an investigational, nonadjudicative setting. Among other things, the Final Rule Investigations sets forth (1) the

Bureau's authority to conduct investigations, and (2) the rights of persons from whom the Bureau seeks to compel information in investigations. For more information, click here.

Adjudicative Proceedings

Title X of the Dodd-Frank Act established the Bureau to regulate the offering and provision of consumer financial products or services under the Federal consumer financial laws. On July 28, 2011, the Bureau promulgated its Rules of Practice Governing Adjudication Proceedings (Interim Final Rule), pursuant to section 1053(e) of the Dodd-Frank Act. The Bureau promulgated the Interim Final Rule with a request for comment; the comment period ended on September 26, 2011. After reviewing and considering the issues raised by the comments, the Bureau is now promulgating, in final form, its Rules of Practice Governing Adjudication Proceedings (Final Rule Adjudication) establishing procedures for the conduct of adjudication proceedings conducted pursuant to section 1053 of the Dodd-Frank Act. Section 1053 of the Dodd-Frank Act authorizes the Bureau to conduct administrative adjudications to ensure or enforce compliance with (a) the provisions of Title X of the Dodd-Frank Act, (b) the rules prescribed by the Bureau under Title X of the Dodd-Frank Act, and (c) any other Federal law or regulation that the Bureau is authorized to enforce. The Final Rule Adjudication does not apply to proceedings governing the issuance of a temporary order to cease and desist pursuant to section 1053(c) of the Dodd-Frank Act. As discussed in greater detail below, the Bureau currently intends to address such proceedings in a future rulemaking. For more information, click here.

Notifications by State Officials

Section 1042 of the Dodd-Frank Act, governs the enforcement powers of the States under the Dodd-Frank Act. Under section 1042(a), a State attorney general or regulator (State Official) may bring an action to enforce Title X of the Dodd-Frank Act and regulations issued thereunder. Prior to initiating any such action, the State Official is required to provide notice of the action to the Bureau and the banking regulator, if any, pursuant to section 1042(b) of the Dodd-Frank Act. Section 1042(b) further authorizes the Bureau to intervene in the State Official's action as a party, remove the action to a Federal district court, and appeal any order or judgment.

On July 28, 2011, the Bureau promulgated the State Official Notification Rule (Interim Final Rule) with a request for comment. The comment period for the Interim Final Rule ended on September 26, 2011. Like the Interim Final Rule, the Final Rule Notifications implements a procedure for the timing and content of the notice required by section 1042(b), sets forth the responsibilities of the recipients of the notice, and specifies the rights of the Bureau to participate in actions brought by State Officials under section 1042(a) of the Dodd-Frank Act. In drafting the Final Rule Notifications, the Bureau endeavored to create a process that would provide both the Bureau and, where applicable, the prudential regulators with timely notice of pending actions and account for the investigation and litigation needs of state regulators and law enforcement agencies. In keeping with this approach, the Final Rule Notifications provides for a default notice period of at least ten calendar days, with exceptions for emergencies and other extenuating circumstances, and requires substantive notice that is both straightforward and comprehensive. The Final Rule Notifications further makes clear that the Bureau can intervene as a party in an action brought by a State Official under Title X of the Dodd-Frank Act or a regulation prescribed thereunder, provides for the confidential treatment of non-public information contained in the notice if a state so requests, and provides that provision of notice shall not be deemed a waiver of any applicable privilege. In addition, the Final Rule Notifications specifies that the notice provisions do not create any procedural or substantive rights for parties in litigation against the United States or against a state that brings an action under Title X of the Dodd-Frank Act or a regulation prescribed thereunder. For more information, click here.

UK DEVELOPMENTS

FSA Publishes Guide to PRA and FCA Handbooks

On June 1, the UK Financial Services Authority (FSA) published a short guide to its plans for dividing the FSA Handbook into handbooks for the its two successor regulators – the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), when the PRA and the FCA acquire their legal powers, and the FSA is abolished in its current form. This will occur on a date yet to be fixed, likely to be in the first half of 2013.

The FSA Handbook will be split between the FCA and the PRA to form two new handbooks, one for the PRA and one for the FCA. Most provisions in the FSA Handbook will be incorporated into the PRA's Handbook, the FCA's Handbook, or both, in line with each new regulator's responsibilities and objectives.

The guide states that in some areas substantive changes will be made to reflect the existence of the two new regulators and their respective roles and powers. This is likely to include such aspects as the future processes for permissions, passporting, controlled functions, threshold conditions and enforcement powers. Any substantive changes will be subject to external consultation.

Meanwhile, changes to the FSA Handbook as a result of EU legislation and ongoing FSA policy initiatives will continue to be made. After acquiring their powers, the FCA and the PRA will amend their rules in accordance with the processes laid down in the relevant statutory materials, including cooperation between them and external consultation.

Draft FCA and PRA Handbooks will be published in early 2013. For more information, click here.

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