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SEC / CORPORATE

SEC Division of Corporation Finance Issues C&DI Clarifying Exemptions for Non-GAAP Information in Forecasts for M&A Transactions

On October 17, the staff of the Securities and Exchange Commission's Division of Corporation Finance issued guidance related to the scope of Regulation G's exemption for disclosure of non-generally accepted accounting principles (GAAP) information.

Item 10(e)(5) of Regulation S-K and Rule 101(a)(3) of Regulation G provide that a non-GAAP financial measure does not include financial measures required to be disclosed by GAAP, SEC rules, or a system of regulation of a government or governmental authority or self-regulatory organization that is applicable to the registrant. C&DI 101.01 specifies that financial measures provided to a financial advisor would be excluded from the definition of non-GAAP financial measures, and therefore would not be subject to Item 10(e) of Regulation S-K or Regulation G, if and to the extent the following conditions are satisfied:

- The financial measures are included in forecasts provided to a financial advisor for the purpose of rendering an opinion that is materially related to the business combination transaction; and
- The forecasts are being disclosed in order to comply with Item 1015 of Regulation M-A or requirements under state or foreign law with respect to the disclosure of a financial advisor's analyses or substantive work.

The full text of the C&DI is available here.

DERIVATIVES

Reminder: EU Variation Margin Rules Apply to Physically Settled FX Forwards Beginning January 3, 2018

Starting January 3, 2018, physically settled foreign exchange forward transactions (FX Forwards) will be subject to the variation (but not initial) margin requirements set out in Commission Delegated Regulation (EU) 2016/2251 of October 4, 2016 (EU Margin Regulation) that apply generally to OTC derivatives. FX Forwards are defined in Article 27 of the EU Margin Regulation as "physically settled OTC derivative contracts that solely involve the exchange of two different currencies on a specific future date at a fixed rate agreed on the trade date of the contract covering the exchange."

The EU Margin Regulation permanently exempted FX Forwards and physically settled foreign-exchange swaps (FX Swaps)[1] from initial margin requirements, but provided FX Forwards, but not FX Swaps, a transitional exemption from variation margin requirements. This transitional exemption ends on January 3, 2018, at which time any FX Forward that is not a "spot contract" becomes subject to variation margin if one or both of the parties to the FX Forward is a financial counterparty (FC) or a non-financial counterparty above a clearing threshold (NFC+) established in the EU, or a third country entity that would be an FC or NFC+ (if its counterparty is an actual FC or NFC+). A "spot contract" is defined in paragraph 2 of Article 10 of Commission Delegated Regulation (EU) 2017/565 of April 25, 2016 as follows:

> A spot contract . . . shall be a contract for the exchange of one currency against another currency, under the terms of which delivery is scheduled to be made within the longer of the following periods:
>
> (a) 2 trading days in respect of any pair of the major currencies set out in paragraph 3[2];
>
> (b) for any pair of currencies where at least one currency is not a major currency, the longer of 2 trading days or the period generally accepted in the market for that currency pair as the standard delivery period;
>
> (c) where the contract for the exchange of those currencies is used for the main purpose of the sale or purchase of a transferable security or a unit in a collective investment undertaking, the period generally accepted in the market for the settlement of that transferable security or a unit in a collective investment undertaking as the standard delivery period or 5 trading days, whichever is shorter.

To address the issue of "rolling spot," the definition also specifies that "[a] contract shall not be considered a spot contract where, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the currency is to be postponed and not to be performed within the [prescribed] period."
The change in the margin status of FX Forwards will complicate the recent effort of the US and the EU to harmonize their rules for derivatives since FX Forwards are not swaps for the purposes of the CFTC's swap margin regulations. In particular, the EU decision concerning the equivalence of the CFTC's margin rules contains the caveat that "[t]his Decision should therefore only apply to OTC derivatives that are subject to margins under both the Union law and the CFTC Regulations."

For parties that use International Swaps and Derivatives credit support annexes that already apply to all transactions between the parties without regard to whether the transactions are technically subject to regulatory margin requirements, FX Forwards subject to the EU Margin Regulations should not create any practical issues. Others will have to make decisions about how they trade FX Forwards. In particular, non-EU entities may want to curtail their FX Forward activity with EU counterparties.

The EU Margin Regulation is available here.

The definition of a "spot contract" is available here.

The EU equivalence decision concerning CFTC margin rules is available here.

[1] An FX Swap is defined under Article 27 of the EU Margin Regulation as a physically settled OTC derivative contract that solely involves an exchange of two different currencies on a specific date at a fixed rate that is agreed on the trade date of the contract covering the exchange, and a reverse exchange of the two currencies at a later date and at a fixed rate that is also agreed on the trade date of the contract covering the exchange.

[2] The major currencies for the purposes of this definition are the US dollar, Euro, Japanese yen, Pound sterling, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, Swedish krona, New Zealand dollar, Singapore dollar, Norwegian krone, Mexican peso, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish złoty and Romanian leu.

See "CFTC Extends No-Action Relief to SEFs Related to Certain Audit Trail Requirements" and "CFTC Extends No-Action Relief for Certain Swaps Executed as Part of Packaged Transactions" in the CFTC section.

CFTC

CFTC Extends No-Action Relief for Certain Swaps Executed as Part of Packaged Transactions

On October 31, the Commodity Futures Trading Commission's Division of Market Oversight extended no-action relief for certain swaps executed as part of packaged transactions. Transactions where at least one swap is subject to a trade execution requirement and either (1) at least one individual component is a bond issued and sold in the primary market or (2) all other components are futures contracts, are provided relief from the following requirements:

- Commodity Exchange Act (CEA) Section 2(h)(8) (providing relief from the requirement that the swap components of the transaction subject to the trade execution requirement be executed on a swap execution facility (SEF) or designated contract market (DCM));

- CFTC Regulation 37.9 and CEA Section 5(d) (allowing an SEF or DCM to offer any method of execution for swap components); and

- CFTC Regulation 37.3(a)(2) (permitting SEFs to not offer an order book as a minimum trading functionality for swap components).

The following transactions are provided the relief described in the second and third bullet points above:

- Transactions where at least the swap component is subject to the trade execution requirement and:

  - at least one of the components is a CFTC swap that is not subject to the clearing requirement;
  - at least one of the components is not a swap; or
  - at least one of the components is a swap over which the CFTC does not have exclusive jurisdiction.

The no-action relief expires November 15, 2020. The CFTC's announcement is available here.

CFTC Extends No-Action Relief to SEFs Related to Certain Audit Trail Requirements

On October 31, the Commodity Futures Trading Commission's Division of Market Oversight extended no-action relief to swap execution facilities (SEFs) from the requirement to capture post-execution allocation information in their audit trail data. To rely on the no-action relief, SEFs must (1) have a rule requiring market participations to provide post-execution allocation information upon request if the SEF, at the request of the CFTC or otherwise, requests such information, and (2) in the course of a trade practice or market surveillance investigation involving post-execution allocations, request and evaluate post-execution allocation information as part of the investigation. The no-action relief expires November 15, 2020.

The CFTC's announcement is available here.

CFTC Grants Amended Order With Respect to Foreign Futures Contracts Listed on the Dubai Mercantile Exchange

On October 31, the Commodity Futures Trading Commission issued an order to the Chicago Mercantile Exchange (CME) and its clearing members that are registered futures commission merchants with regard to foreign futures contracts currently listed or that will be listed in the future for trading on the Dubai Mercantile Exchange (DME) and cleared by the CME. The order allows the commingling of funds related to such foreign futures contracts with customer funds related to futures contracts in accounts segregated in accordance with Section 4d of the Commodity Exchange Act.

The order expands a previous CFTC order, which pertained to a more limited scope of DME contracts.

The CFTC's announcement is available here.

UK DEVELOPMENTS

FCA Publishes Regtech Website

On November 1, the UK Financial Conduct Authority (FCA) published a new page on its website on using technology to enhance regulatory reporting, with respect to model driven machine executable regulatory reporting.

The FCA explains that one of the key technology areas on which it is focusing is the development of solutions to the increasing challenges faced by financial institutions in implementing their regulatory reporting obligations. It is

exploring, with the Bank of England (BoE), how technology can be used to link regulation, compliance procedures, and firms' policies and standards, together with firms' transactional applications and databases.

If successful, the FCA believes a machine readable regulatory environment could "transform and fundamentally change" how the financial services industry understands, interprets and then reports regulatory information. Firms would be able to map their regulatory requirements directly to the data that they hold, which would, in turn, create the potential for automated, straight-through-processing of regulatory returns.

In the FCA's view, this would benefit both firms and regulators by improving the accuracy of data submissions and reducing their costs; ensuring that changes to regulatory requirements could be implemented more quickly; and potentially reducing compliance costs, thereby lowering barriers to entry and increasing competition.

The FCA is hosting events designed to build on previous regtech initiatives and, with the BoE, will engage more broadly with the industry through a series of roundtables. Their findings will be progressively shared to assess both the potential of this work and how it can be implemented across the UK financial services sector.

The website is available here.

EU DEVELOPMENTS

See "Reminder: EU Variation Margin Rules Apply to Physically Settled FX Forwards Beginning January 3, 2018" in the Derivatives section.

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

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