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Corporate & Financial
Weekly Digest

November 10, 2017 Volume XII, Issue 43

SEC / CORPORATE

SEC Staff Publishes New Guidance on Shareholder Proposals

On November 1, the Division of Corporation Finance of the Securities and Exchange Commission (Division) published Staff Legal Bulletin No. 14I (SLB 14I), which provides new, issuer-friendly guidance on shareholder proposals in advance of the 2018 proxy season. Specifically, SLB 14I provides guidance on (1) exclusion of shareholder proposals under the "ordinary business" and "economic relevance" exceptions under Rule 14a-8 of the Securities Exchange Act of 1934; (2) proposals submitted on behalf of shareholders through a representative; and (3) the use of images in proposals.

The following is a brief summary of SLB 14I:

1. "Ordinary Business" Exception

The "ordinary business" exception under Rule 14a-8(i)(7) allows a company to exclude a shareholder proposal that deals with matters "so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight." The Division has traditionally accepted an exception to this exclusion for proposals that "focus on policy issues that are sufficiently significant because they transcend ordinary business." SLB 14I has clarified that a board of directors is well situated to analyze whether an issue is significant and the Division will expect a board analysis regarding the particular policy issue raised in a company's no-action request with respect to exclusion of a proposal. The Division noted that an explanation would be most helpful if it detailed the specific processes employed by the board to ensure that its conclusions are well-informed and well-reasoned.

2. "Economic Relevance" Exception

The "economic relevance" exception under Rule 14a-8(i)(5) allows a company to exclude a shareholder proposal that "relates to operations which account for less than 5% of the company's total assets at the end of its most recent fiscal year, and for less than 5% of net earnings and gross sales for its most recent fiscal year, and is not otherwise significantly related to the company's business." Traditionally, however, the Division has not issued a no-action letter with respect to the exclusion of the proposal "where the proposal has reflected social or economic issues, rather than economic concerns" and the company conducted any business that related to the proposal, no matter how insignificant. In SLB 14I, the Division clarified that it will now focus on how the proposal is "significantly related to the company's business," regardless of broader social or ethical issues the proposal may present. The Division noted that a board of directors acting with knowledge of the company's business is better suited than the Division to determine if a proposal is "significantly related" to that business and accordingly would expect a no-action request to include a detailed board analysis. Additionally, the Division noted that it will no longer look to its analysis under Rule 14a-8(i)(7) (ordinary business exception), when evaluating arguments under Rule 14a-8(i)(5) (economic relevance exception).

3. Proposals by Proxy

Although Rule 14a-8 does not explicitly address the ability of shareholders to submit proposals through a representative, shareholders frequently do so (commonly referred to as "proposals by proxy"). The Division clarified that, to help the Division and company evaluate whether the eligibility requirements of 14a-8(b) have been

satisfied by a shareholder submitting a proposal by proxy, a proponent submitting a shareholder proposal must provide documentation that is executed by the shareholder and describe the shareholder's delegation of authority to the proxy, including:

- the identity of the shareholder-proponent and the person or entity selected as proxy;
- the identity of the company to which the proposal is directed;
- the annual or special meeting for which the proposal is submitted; and
- the specific proposal to be submitted (e.g., proposal to lower the threshold for calling a special meeting from 25% to 10%).

4. The Use of Images

Rule 14a-8(d) provides that a "proposal, including any accompanying supporting statement, may not exceed 500 words." SLB 14I has clarified that the use of graphs and images is not prohibited in proposals; however, exclusion of graphs and/or images is appropriate under Rule 14a-8(i)(3) where they:

- make the proposal materially false or misleading;
- render the proposal inherently vague or indefinite;
- directly or indirectly impugn character or make charges of improper, illegal or immoral conduct, without factual foundation; or
- are irrelevant to a consideration of the subject matter of the proposal.

SLB 14I also noted that exclusion of graphs and/or images is appropriate if the total number of words in the shareholder proposal, including the words and/or graphics, exceeds 500.

SLB 14I is available here.

BROKER-DEALER

SEC Approves a Longer Period to Review Fees for the Consolidated Audit Trail

Earlier this year, several exchanges and the Financial Industry Regulatory Authority filed proposed rule changes to adopt industry member fees that would fund the consolidated audit trail (CAT). The proposed rule changes were immediately effective upon filing with the Securities and Exchange Commission. However, on June 30, the SEC temporarily suspended the rules and initiated proceedings to determine whether it should approve the proposed CAT fees.

On November 9, the SEC extended the time period to consider each of the proposed rule changes to January 14, 2018. The SEC release is available here.

FINRA Releases Notice to Members Addressing "Pay-to-Play" Rule for Capital Acquisition Brokers

On November 6, the Financial Industry Regulatory Authority (FINRA) released Notice to Members 17-37, which provides information about the Pay-to-Play rule applicable to capital acquisition brokers (CABs). The Securities and Exchange Commission's pay-to-play rules prohibit an investment adviser and its covered associates from providing or agreeing to provide payment to any person to solicit a government entity for investment advisory services on behalf of the investment adviser, unless the person is a "regulated person."

FINRA's new rule clarifies that CABs are subject to the same pay-to-play restrictions already applicable to non-CAB member firms and that CABs, therefore, constitute "regulated persons" for purposes of the SEC's pay-to-play rules. Please see the October 6 edition of the *Corporate & Financial Weekly Digest* for more information.

DERIVATIVES

See "CFTC's Division of Clearing and Risk Provides No-Action Relief to Certain Foreign Financial Institutions From Swap Clearing Requirements" in the CFTC section.

CFTC

CFTC's Division of Clearing and Risk Provides No-Action Relief to Certain Foreign Financial Institutions From Swap Clearing Requirements

On November 7, the Commodity Futures Trading Commission's (CFTC) Division of Clearing and Risk (DCR) published Staff Letters 17-57, 17-58 and 17-59 (Staff Letters), which provided Banco Centroamericano de Integración Económica, the European Stability Mechanism, and the North American Development Bank, respectively, with no-action relief from the swap clearing requirements set forth in Section 2(h)(1) of the Commodity Exchange Act (Clearing Requirement), as implemented by CFTC Regulations 50.2 and 50.4. In each instance, DCR determined that granting such no-action relief was consistent with the end-user exception to the Clearing Requirement (End-User Exception). (For a more complete discussion of the End-User Exception, please refer to the July 13, 2012 edition of *Corporate & Financial Weekly Digest*). The Staff Letters note that the non-action relief provided thereunder does not extend to other provisions of the Commodity Exchange Act and CFTC regulations, such as the recordkeeping and reporting requirements under parts 23 and 45 of the CFTC's regulations.

Staff Letter 17-57 is available here.

Staff Letter 17-58 is available here.

Staff Letter 17-59 is available here.

UK DEVELOPMENTS

FCA Publishes Issue 54 of Market Watch Newsletter

On November 8, the UK Financial Conduct Authority (FCA) published issue 54 of Market Watch, its newsletter on market conduct and transaction reporting issues.

With the January 3, 2018 implementation date of the revised Markets in Financial Instruments Directive (MiFID II) and Markets in Financial Instruments Regulation (MiFIR) fast approaching, Market Watch contains articles relating to:

- Legal entity identifiers (LEIs)—the FCA reminds firms with transaction reporting obligations that they must ensure they have an LEI and keep it updated. It has produced a leaflet that executing firms can use in their communications with clients. It also reminds clients that are legal entities or structures, including company charities or trusts, to make arrangements to obtain an LEI code if they want executing firms to continue to act on their instructions or make decisions to trade on their behalf from January 3, 2018, onwards.
- ESMA instrument reference data—the FCA highlights the launch by ESMA of its Financial Instruments Reference Data System database.
- FCA transitional arrangements—on January 12, 2018, the FCA is decommissioning its current transaction reporting system, ZEN. The FCA will use its new FCA Market Data Processor IT system (MDP) to meet the new transaction reporting requirements under MiFIR. Market Watch also contains information on the FCA's previously stated approach to the January transition away from the pre-MiFID II reporting regime.
- MiFID II and market data obligations—the FCA's MDP industry test environment is available, and the FCA encourages firms to begin testing as soon as possible.

- Authorizations and variation of permissions—the FCA advises firms that, if they have not yet applied for new permissions under MiFID II, they urgently need to submit an application with all the required information.

Market Watch is available here.

FCA Publishes Speech on Robo Advice

On November 3, the UK Financial Conduct Authority (FCA) published a speech by Bob Ferguson, FCA Head of Department, Strategy Competition Division, giving the FCA's perspective on robo advice.

Key points of the speech include:

- the FCA sees automated advice as a valuable vehicle to help tackle the issues faced by those consumers who are unserved or underserved by more traditional advice models, as well as promoting competition in the UK financial advice market;
- the FCA's Advice Unit continues to be active in providing regulatory feedback and external tools to firms developing an automated advice (or guidance) model;
- the FCA believes automated advice brings its own risks, but well-designed models have great potential for compliance risk reduction; and
- the FCA will supervise robo advice firms with a focus on outcomes, looking at the suitability of recommendations for the consumer and acting where it sees harm.

The speech can be found here.

FCA Publishes Alert for Firms Who Have Appointed Representatives

On November 3, the UK Financial Conduct Authority (FCA) published an alert addressed to all firms who have Appointed Representatives or Introducer Appointed Representatives (ARs). An AR is a person who conducts regulated activities and acts on behalf or under the regulatory structure/licence of an authorized firm (its principal).

The FCA is particularly concerned about (1) the influence that an introducer may have over a principal firm and its ARs; (2) the risk that ARs may be providing regulated activities outside of the arrangement they have with the principal firm; (3) principal firms appointing ARs when they are not actually necessary; and (4) principal firms performing insufficient due diligence and monitoring of ARs.

The FCA expects principal firms to review and consider:

- the introducer relationships they and their ARs have to determine if their firm is under undue influence;
- their AR relationships to ensure they remain necessary, appropriate and relevant for their type of business;
- their processes in relation to persons with significant control and senior management responsibilities/functions within their ARs;
- whether their AR and introducer due diligence and monitoring processes are adequate;
- whether they need to take any additional steps to ensure the actions of their ARs are compatible with their obligations as an AR and allow them to meet their regulatory responsibilities; and
- a previous alert issued by the FCA on August 2, 2016, available here.

The alert is available here.

FCA Opens Consultation on Expectations of Firms in Unregulated Markets and Industry Codes of Conduct

On November 3, the UK Financial Conduct Authority (FCA) published a consultation paper (CP17/37) on supervising adherence to proper standards of market conduct for unregulated markets and activities, including standards set out in industry-written codes of conduct.

In the introduction to CP17/37, the FCA states that firms and their staff should be clear about the FCA's expectations of good conduct. However, the FCA understands that, for markets and activities not covered by

regulatory rules and FCA Principles, its expectations may not be clear. CP17/37 is aimed at helping to resolve this issue.

The FCA proposes a general approach to supervising and enforcing the Senior Managers & Certification Regime (SM&CR) rules for authorized firms' unregulated activities, including those covered by industry-written codes of conduct (for further information on the SM&CR, please see the *Corporate & Financial Weekly Digest* of July 28, 2017). The FCA expects firms and their senior management to consider market codes in determining the "proper standard of market conduct" as part of the SM&CR requirements and obligations, including in market sectors where the FCA does not have a framework of its own rules. The FCA will supervise adherence to those SM&CR rules and may take enforcement action in cases of serious and egregious misconduct leading to harm or potential harm.

The FCA also proposes that it should publicly recognize particular industry codes of conduct that, in its view, set out proper standards of market conduct for unregulated markets and activities. This proposed approach means it would review and assess industry codes against new criteria and would then publicly state that it considers a particular code is a helpful explanation of the proper standard of market conduct for a particular market or activity. The FCA intends that this approach should encourage participants to adhere to that code. However, the FCA does not intend to give any such codes binding regulatory status, and industry codes will remain voluntary.

The FCA also discusses extending the application of Principle 5 of the FCA's Principles for Businesses (which requires firms to observe proper standards of market conduct) to unregulated activities. The FCA considers that this would help ensure its expectations of firms are clear.

Comments can be made on the proposals in CP17/37 until February 5, 2018. The FCA expects to publish a policy statement in the second quarter of 2018.

CP17/37 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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