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SEC/CORPORATE

SEC Proposes New Rules for Crowdfunding Exemption

On October 23, the Securities and Exchange Commission voted unanimously to propose new rules that would permit companies to offer and sell securities through "crowdfunding." Title III of the Jumpstart Our Business Startups Act requires the SEC to adopt rules implementing the exemption from registration under the Securities Act of 1933 (Securities Act) provided by Section 4(a)(6) of the Securities Act (Crowdfunding Exemption) for offers and sales of securities through online crowdfunding platforms. Generally speaking, the Crowdfunding Exemption is intended to facilitate capital formation by startups and small businesses by allowing certain companies to raise up to $1 million in any 12-month period through online crowdfunding "portals" in exchange for securities.

The proposed rules would limit the amount a single investor could invest in crowdfunding transactions during any 12-month period. Specifically, in the case of an investor having annual income *and* net worth of less than $100,000, the investor would only be permitted to invest $2,000 or 5% of such investor's annual income or net worth (whichever is greater). In the case of an investor with annual income *or* net worth of at least $100,000, the investor would only be permitted to invest 10% of such investor's net worth or annual income (whichever is greater) in crowdfunding transactions. The proposed rules set forth a framework for determining an investor's net worth and net income and would permit an issuer to rely on the applicable crowdfunding intermediary to determine the amount of securities purchased by an investor in crowdfunding transactions to ensure the investor has not exceeded his or her limit.

The proposed rules also provide a framework for disclosure in offering materials used to offer securities pursuant to the Crowdfunding Exemption and in annual reports, which an issuer would be required to file after completing an offering in reliance on the Crowdfunding Exemption. In connection with a crowdfunding offering, an issuer would be required to file with the SEC and provide to potential investors (through the issuer's website) an offering statement on new "Form C," which would require scaled disclosure regarding, among other things, the issuer; the issuer's officers, directors and beneficial owners of 20% or more of its voting equity; a business plan; the use of proceeds from the offering; the target offering amount and deadline for completing the offering; the circumstances under which the issuer may close the offering prior to the stated deadline and any requirements for investors to confirm their investment commitment, as well as the fact that committed capital will be returned if the target offering amount is not reached before the offering deadline; the offering price; ownership and capital structure; risk factors; compensation paid to the intermediary; and related party transactions.

The proposal also clarifies the financial disclosure that would be required in an offering statement. In the case of offerings of more than $100,000 but less than $500,000 of securities, an issuer would be required to provide reviewed financial statements and, in the case of offerings of more than $500,000 of an issuer's securities, the issuer would be required to provide audited financial statements. For purposes of calculating the offering amount, the proposal would require an issuer to include all offerings made in reliance on the Crowdfunding Exemption within the preceding 12-month period. In addition, an issuer would be required to include in an offering statement a discussion of the issuer's historical results of operation, liquidity and capital resources. Once an issuer completes a crowdfunding offering, it would be subject to ongoing reporting obligations, which would require disclosure of information similar to the information regarding the issuer, its financial condition and the securities

offered as would be required in the offering statement. The proposed rules specify the circumstances in which an issuer's annual reporting obligations would terminate.

The proposed rules also provide that all crowdfunding transactions conducted in reliance on the Crowdfunding Exemption must be effected through a single online intermediary registered with the SEC as a "funding portal." The proposed rules include various requirements for funding portals, including requirements that the portal provide communication channels to facilitate sharing of information that will allow communication among potential investors (i.e., the "crowd"), make educational materials available to potential investors, take measures to reduce fraud and make available information about issuers. Under the proposed rules, a funding portal would be prohibited from providing investment advice or recommendations, soliciting purchases or sales of securities offered or displayed on its website, handling investor funds, effecting secondary transactions in securities and engaging in certain compensation practices.

The proposal included 295 specific requests for comment, and is subject to public comment for a period of 90 days from the date the proposal is published in the *Federal Register*. Until the SEC adopts final rules relating to crowdfunding transactions and such rules become effective, issuers and intermediaries may not rely on the exemption provided by Section 4(a)(6) of the Securities Act.

To view the complete text of the proposal, click here.

CFTC

CFTC Provides Clarification for SD and MSP Employees Acting in Clerical or Ministerial Capacities

The Commodity Exchange Act and Commodity Futures Trading Commission regulations make it unlawful for a swap dealer (SD) or major swap participant (MSP) to permit a person subject to a statutory disqualification to effect or be involved in effecting swaps on behalf of the SD or MSP. The CFTC amended CFTC Regulation 23.22(a) to clarify that such prohibition does not apply to individuals employed in a clerical or ministerial capacity.

The adopting release is available here.

CFTC Requests Public Comment on MAT Filings by Javelin and trueEX

The Commodity Futures Trading Commission has requested public comment on determinations by Javelin SEF, LLC (Javelin) and trueEX, LLC (trueEX) to make certain interest rate swaps "available to trade." Once those determinations become effective, market participants that are not eligible for the "end-user" exception in Section 2(h)(7) of the Commodity Exchange Act would only be able to trade swaps that have been made available to trade (MAT) on a swap execution facility or a designated contract market.

Javelin's MAT filing covers a broad range of interest rate products, including fixed-to-floating and floating-to-floating swaps referencing US dollar London Interbank Offered Rate (LIBOR), British pound sterling LIBOR and Euro Interbank Offered Rate (EURIBOR). The tenors for such swaps range from 1 month to 51 years.

In contrast, trueEX's MAT filing covers a much narrower set of interest rate swaps, including fixed-to-floating par coupon and Standard Coupon Standard Maturity swaps referencing US dollar LIBOR. The tenors for such swaps are set at 2, 3, 5, 7, 10, 15, 20 and 30 years or 1, 2, 3, 5, 7, 10, 15, 20 and 30 years, respectively.

Javelin and trueEX filed their respective MAT determinations as rule certifications subject to a 10-day review period. Pursuant to CFTC Regulation 40.6(c), the CFTC issued a 90-day stay on both MAT filings, which includes a 30-day public comment period for each filing.

The comment period for Javelin's filing closes on November 19, 2013; the comment period for trueEX's filing closes on November 21, 2013. Comments may be submitted electronically through the CFTC's website comment submission portal.

Javelin's MAT filing is available here.

trueEX's MAT filing is available here.

CFTC Extends Relief from *De Minimis* Exception to Certain Non-US Affiliates

The Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) issued no-action relief to non-US persons that are not guaranteed or conduit affiliates of US persons (Non-Guaranteed Non-US Persons) from counting certain swaps toward the swap dealer (SD) *de minimis* threshold.

In its Cross-Border Interpretive Guidance and Policy Statement, the CFTC stated that Non-Guaranteed Non-US Persons do not need to count swaps with certain persons, including a guaranteed affiliate of a US person that is a swap dealer (Guaranteed SD Affiliate). DSIO's no-action relief extends this policy by granting relief under circumstances in which a Guaranteed SD Affiliate has crossed the *de minimis* threshold and is therefore required to register as an SD within two months.

Pursuant to the no-action relief, a Non-Guaranteed Non-US Person is not required to include, for *de minimis* calculation purposes, swaps traded with a Guaranteed SD Affiliate during the two-month period after which the Guaranteed SD Affiliate has crossed the *de minimis* threshold. Such relief is subject to certain conditions, including a requirement that the Guaranteed SD Affiliate represent in writing that the Guaranteed SD Affiliate intends to register as an SD and the date by which it is required to register. A copy of such representation must be sent to DSIO via electronic mail within 48 hours of execution of the swap.

CFTC Letter No. 13-64 is available here.

LITIGATION

Southern District of New York Limits Dodd-Frank Whistleblower Protections to the United States

The US District Court for the Southern District of New York limited the scope of the Dodd-Frank Wall Street Reform and Consumer Protection Act anti-retaliation provisions for whistleblowers to the United States, dismissing a complaint by an overseas former employee against Siemens A.G., the German multinational corporation. Plaintiff Meng-Lin Liu, a resident of Taiwan and former compliance officer for Siemens China, alleged that Siemens China used kickbacks to boost medical sales in North Korea and China. He filed suit against Siemens A.G. in the United States when he suffered negative employment actions, including poor reviews and early termination of his employment contract, after raising concerns about alleged violations of the Foreign Corrupt Practices Act (FCPA). Liu reported his FCPA allegations to the Securities and Exchange Commission following termination of his employment.

Liu argued that his termination was illegal under the Anti-Retaliation Provision of the Dodd-Frank Act, claiming that he should be protected as a "whistleblower" under the statute. However, the District Court determined that the protections for whistleblowers under the Dodd-Frank Act did not extend to this case, agreeing with the one other court to have previously addressed the issue (the Southern District of Texas in a June 2013 decision.)

In analyzing the Anti-Retaliation Provision's applicability to overseas acts, the District Court, relying on the Supreme Court's ruling in *Morrison v. National Australia Bank*, noted that, where a statute gives no clear indication of extraterritorial application, there is a presumption that it is primarily concerned with domestic activity. The fact that the Dodd-Frank Act specifies some extraterritorial application under other provisions, but not the Anti-Retaliation Provision, indicated to the District Court that Congress intended to limit the retaliation protections to domestic activity. Further, the District Court rejected Liu's argument that the fact that Siemens listed American Depository Receipts on the New York Stock Exchange brought Liu into the purview of the Anti-Retaliation Provision, finding that applying US securities law to foreign companies merely because they list securities in the United States is contrary to *Morrison*. The District Court explained that this case was "brought by a Taiwanese resident against a German corporation concerning its Chinese subsidiary relating to alleged corruption in China and North Korea." Allowing overseas application of the whistleblower protections of the statute would be "an intrusion into the employment law of a foreign nation [that] could disrupt the 'delicate field of international relations.'" Consequentially, the District Court dismissed the lawsuit.

Meng-Lin Liu v. Siemens A.G., No. 1:13-cv-00317 (S.D.N.Y. October 21, 2013).

Swiss National and Former Energy Executive Criminally Charged Under FCPA

In an illustration of the extraterritorial reach of the Foreign Corrupt Practices Act (FCPA), Alain Riedo, a Swiss citizen and the general manager of Maxwell Technologies S.A. (Maxwell), a Swiss subsidiary of a US public company, was criminally charged with violating anti-bribery, book and records, and internal control provisions of the FCPA. According to the indictment filed in the Southern District of California, Riedo, along with unidentified co-conspirators and agents, allegedly conspired to, and made, corrupt payments to Chinese government officials and falsely recorded those payments on Maxwell books and records in an effort to retain business, prestige and increased compensation.

Riedo worked for Maxwell, which manufactured and sold high-voltage/high-tension capacitors (HV/HT) in several countries, including China. From October 2002 through May 2009, Riedo allegedly conspired with a senior officer of the US parent company, a manager of the Swiss subsidiary and a Chinese national acting as Maxwell's agent, and caused up to $2 million in bribes to be paid to Chinese government officials in order to obtain HV/HT sales contracts. According to the indictment, the bribery scheme entailed giving prospective customers quotes for HV/HT sales at prices that included a "secret mark-up" of approximately 20 percent. Invoices were prepared reflecting the marked-up prices and the agent in China kicked back the marked-up portion to employees at Chinese state-owned electric utility manufacturers. The indictment alleges that Riedo falsely recorded the inflated payments in Maxwell books, records and accounts as "commissions, sales expenses, or consulting fees." Thereafter, Riedo allegedly electronically transmitted this erroneous financial information to Maxwell's parent company in California, which resulted in errors in the parent's publicly filed consolidated financial statements and other Securities and Exchange Commission filings, including false sub-certifications of the financials.

Riedo—who, according to the indictment, was separated from the company shortly after the alleged conspiracy ended—faces nine counts. No charges were filed against the companies. In fact, the indictment alleges that Riedo and the Chinese agent subverted the corporate compliance program by falsely representing in an internal FCPA questionnaire that they were not aware of any FCPA violations.

United States v. Alain Riedo, No. 13-cr-3789 JM (S.D. Cal. October 15, 2013).

BANKING

Agencies Issue Guidance on Troubled Debt Restructurings

The four federal financial institution regulatory agencies—the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration and the Office of the Comptroller of the Currency (the agencies)—have jointly issued supervisory guidance clarifying certain issues related to the accounting treatment and regulatory classification of commercial and residential real estate loans that have undergone troubled debt restructurings (TDRs). The agencies' guidance reiterates key aspects of previously issued guidance and discusses the definition of a collateral-dependent loan and the classification and charge-off treatment for impaired loans, including TDRs. The guidance highlights the following points:

- A loan in nonaccrual status that is modified in a TDR need not be maintained for its remaining life in nonaccrual status, but can be restored to accrual status if it meets the return-to-accrual conditions in the instructions for the Consolidated Reports of Condition and Income (Call Report).
- A TDR designation means a modified loan is impaired for accounting purposes, but it does not automatically result in an adverse classification. A TDR designation also does not mean that the modified loan should remain adversely classified for its remaining life if it already was, or becomes, adversely classified at the time of the modification.
- An impaired loan, including a TDR, is collateral dependent if repayment is expected to be provided solely by the sale or continued operation of the underlying collateral. In contrast, when the repayment of an impaired loan collateralized by real estate depends on cash flow generated by the operation of a business or sources other than the collateral, the loan generally is not considered collateral dependent.
- For regulatory reporting purposes, an impaired collateral-dependent loan must be measured for impairment based on the fair value of the collateral (less estimated costs to sell, if appropriate) regardless of whether foreclosure is probable. For an impaired loan that is not collateral dependent, impairment must be measured using the present value of expected future cash flows.

The guidance discusses the criteria for determining the amount of any loss classification and charge-off on impaired collateral-dependent loans, separately addressing those for which repayment is dependent on the sale of the collateral versus the operation of the collateral, and on impaired loans that are not collateral dependent.

Read more.

Federal Reserve Issues Proposed Liquidity Requirements; OCC and FDIC Expected to Follow

On October 24, the Board of Governors of the Federal Reserve System, in an expected move, issued tough new liquidity requirements generally applicable to banks with assets over $250 billion and somewhat diluted liquidity requirements for banks over $50 billion. Banks with assets of less than $50 billion are exempt from the proposed rule. The liquidity proposal is based on a standard agreed to by the Basel Committee on Banking Supervision. The rule would also establish, according to the Federal Reserve, "an enhanced prudential liquidity standard consistent with section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act."

The proposal would create a standardized minimum liquidity requirement for large and internationally active banking organizations and systemically important, non-bank financial companies designated by the Financial Stability Oversight Council. These institutions would be required to hold minimum amounts of "high-quality, liquid assets" such as central bank reserves and government and corporate debt "that can be converted easily and quickly into cash." Each institution would be required to hold liquidity in an amount equal to or greater than its projected cash outflows minus its projected cash inflows during a short-term stress period. The ratio of the firm's liquid assets to its projected net cash outflow is its "liquidity coverage ratio" (LCR).

The LCR would apply to all internationally active banking organizations—generally, those with $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure—and to systemically important, non-bank financial institutions. The proposal also would apply a less stringent, modified LCR to bank holding companies and savings and loan holding companies that are not internationally active, but have more than $50 billion in total assets. Bank holding companies and savings and loan holding companies with substantial insurance subsidiaries and non-bank, systemically important financial institutions with substantial insurance operations are not covered by the proposal.

The proposal defines various categories of high quality, liquid assets (HQLA) and also specifies how a firm's projected net cash outflows over the stress period would be calculated using common, standardized assumptions about the outflows and inflows associated with specific liabilities, assets and off-balance-sheet obligations.

Somewhat controversial is the decision of the Federal Reserve to exclude certain assets from those considered to be HQLA by the Basel Committee on Banking Supervision, such as covered bonds, mortgage-backed private-label securities and municipals. The decision to exclude such assets was criticized by the American Bankers Association's Wayne Abernathy, executive vice president for financial institutions policy and regulatory affairs, who, according to the *American Banker*, called the decision "disappointing." The Federal Reserve took the position that the proposed rule is "generally consistent" with the Basel Committee's LCR standard, but admitted in its press release that the rule "is more stringent in several other areas besides the definition of high quality liquid assets, including the assumed rate of outflows of certain kinds of funding." In addition, the proposed transition period is shorter than that included in the Basel agreement. The accelerated transition period "reflects a desire to maintain the improved liquidity positions that [US] institutions have established since the financial crisis, in part as a result of supervisory oversight by the Federal Reserve and other [US] bank regulators." Under the proposal, US firms would begin the LCR transition period on January 1, 2015, and would be required to be fully compliant by January 1, 2017.

Vice-chair and presidential chair nominee Janet Yellen reportedly indicated that the rule was only a first step in regulating liquidity, and that additional measures such as the net stable funding ratio were in the pipeline.

The Federal Reserve developed the proposed rule with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, both of which are expected to propose virtually identical rules in the near future. Comments will be received through January 31, 2014.

More information is available here and here.

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