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CORPORATE & FINANCIAL
WEEKLY DIGEST

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SEC/CORPORATE

SEC Division of Corporation Finance Issues 11 New C&DIs

On November 13, the Securities and Exchange Commission's Division of Corporation Finance issued two new Compliance and Disclosure Interpretations (C&DIs) on Rule 144A under the Securities Act of 1933 (Securities Act) and nine new C&DIs on Rule 506 under the Securities Act. These C&DIs relate to the new rules adopted by the SEC in July that lifted the decades-old ban on general solicitation and advertising in connection with private securities offerings conducted in reliance upon the exemptions from registration provided by Rules 144A and 506. The new C&DIs include the following interpretive guidance:

- C&DI 138.03 provides that, in offerings under Securities Act Rule 144A in which securities were initially sold to financial intermediaries in exempt transactions under Securities Act Section 4(a)(2) or Regulation S, general solicitation may be conducted by the issuer as well as the initial purchasers involved in such exempt transactions and other distribution participants.

- C&DI 138.04 clarifies that the amendments to Rule 144A permitting the use of general solicitation did not change how directed selling efforts under Regulation S are analyzed in concurrent Rule 144A and Regulation S offerings.

- C&DI 260.05 provides that, if an issuer commenced an offering in reliance on Rule 506 prior to the effective date of the new Rule 506(c) exemption and filed a Form D notice for such offering, and if the issuer continues its offering in reliance on the Rule 506(c) exemption, it will be required to amend its Form D to reflect this change.

- C&DI 260.06 clarifies that an issuer will not lose the ability to rely on Rule 506(c) for an offering if securities are purchased in the offering by a person who is not an accredited investor as long as the issuer took reasonable steps to verify that such purchaser was an accredited investor and reasonably believed that such purchaser was an accredited investor at the time of the sale.

- C&DI 260.07 clarifies that, even if all purchasers in an offering are accredited investors, if the issuer failed to take reasonable steps to verify the accredited investor status of the purchasers, the issuer cannot rely on the Rule 506(c) exemption.

- C&DI 260.08 clarifies that, if an issuer relies on one of the specific, non-exclusive verification methods in Rule 506(c) to verify the accredited investor status of a purchaser in an offering, it must satisfy the specific requirements of the method on which it relies. However, if the issuer is not able to satisfy these requirements to rely on one of these methods, it may instead determine whether it has taken reasonable steps to verify the purchaser's accredited investor status under the principles-based approach to verification.

- C&DI 260.09 states that the third-party verification method in the non-exclusive list of verification methods in Rule 506(c) is not limited to written confirmations from attorneys and certified public accountants who are licensed or registered in a US jurisdiction and may include such individuals who are licensed or registered in foreign jurisdictions.

- C&DI 260.10 clarifies that the verification method for existing investors in the non-exclusive list of verification methods in Rule 506(c) is limited to existing investors that purchased securities in the same issuer's Rule 506(b) offering as accredited investors prior to September 23, 2013, and continue to hold such securities. Specifically, even if a new issuer has the same sponsor as the issuer in which the investor purchased securities in a prior Rule 506(b) offering, it may not use this method of verification.

- C&DI 260.11 states that an issuer that commenced an offering intending to rely on Rule 506(c) and did not engage in any form of general solicitation may subsequently determine to rely on Rule 506(b) for the offering as long as the conditions of Rule 506(b) have been satisfied.

- C&DI 260.12 states that an issuer that commenced an offering in reliance on Rule 506(b) may determine, prior to any sales of securities, to rely on Rule 506(c), as long as the conditions of Rule 506(c) are satisfied.

- C&DI 260.13 clarifies that, if an issuer has engaged in general solicitation in connection with an offering but fails to satisfy the conditions of Rule 506(c), the Securities Act Section 4(a)(2) private offering exemption will not be available to the issuer with respect to such offering.

Register for Our 2014 Proxy Season Update Webinar

On Tuesday, December 10 at 12:00 p.m. CST, please join Katten Muchin Rosenman LLP, Ernst & Young LLP and Georgeson Inc. for a timely discussion via webcast of key developments and trends impacting public companies in the 2014 Annual Report and Proxy Season.

Further details are available here; click here to register.

CFTC

CFTC Issues Cross-Border Transactions Advisory

On November 14, the Division of Swap Dealer and Intermediary Oversight (DSIO) of the Commodity Futures Trading Commission issued Advisory No. 13-69 to answer inquiries on whether a registered non-US swap dealer (SD) must comply with the Transaction-Level Requirements when entering into a swap with a non-US person if the swap is arranged, negotiated or executed by personnel or agents of the non-US SD located in the United States. DSIO advised that, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the CFTC has a supervisory interest in dealing activities that occur in the United States, regardless of the status of the counterparties. Such swaps are therefore subject to Transaction-Level Requirements if the non-US SD (whether or not an affiliate of a US person) "regularly" uses personnel or agents that are located in the United States. DSIO further indicated, "for the avoidance of doubt," that these requirements would also apply to a swap between a non-US SD and a non-US person that is booked in a non-US branch of the non-US SD if the non-US SD is using personnel or agents located in the United States to arrange, negotiate or execute the swap.

The Advisory is available here.

CFTC Issues Guidance Regarding Swap Execution Facilities

On November 14, the Commodity Futures Trading Commission's Divisions of Clearing and Risk, Market Oversight and Swap Dealer and Intermediary Oversight (the Divisions) issued guidance to swap execution facilities (SEFs) and applicants for registration as SEFs on restrictions related to intended-to-be-cleared swaps (ITBC Swaps) that are executed on SEFs and access requirements for eligible contract participants (ECPs).

The guidance addresses "enablement mechanisms," which the Divisions defined broadly to mean any device that prevents a market participant from interacting, trading with or viewing bids and offers from any other market participant on the SEF. In the Divisions' view, these restrictions are inconsistent with the SEF core principles and CFTC Regulation 37.202. The Divisions noted that, because ITBC swaps are subject to pre-execution credit checks and trades that fail to clear are void *ab initio* under SEF rules, enablement mechanisms are not necessary to eliminate credit risk. The guidance further takes the position that enablement mechanisms are inconsistent with other CFTC Regulations regarding SEF order books, request for quote systems and counterparty limitations.

The guidance also addresses restrictions on market access by ECPs. The guidance reflects the Divisions' view that SEFs may not, consistent with the impartial access requirement, limit access to their trading platforms to certain types of ECPs. The guidance further notes that while SEFs must require a market participant to have a clearing agreement with a clearing member prior to executing a swap, SEFs cannot require that the trade be executed through a clearing member.

The Divisions' guidance is available here.

LITIGATION

Third Circuit Finds Delaware Chancery's Arbitration Program Unconstitutional

A three-judge panel of the US Court of Appeals for the Third Circuit recently affirmed an injunction against the Delaware Court of Chancery's arbitration program, finding that the confidential proceedings violate the First Amendment right of public access.

In 2011, the Delaware Coalition for Open Government challenged an arbitration program created by the Delaware General Assembly in 2009. Under the program, parties may agree to submit private business disputes for arbitration before any sitting judge of the Court of Chancery, provided that at least one of the parties is a Delaware entity, neither party is a consumer and the amount in controversy exceeds $1 million.

In 2012, the US District Court for the District of Delaware enjoined the arbitration program, holding that the proceedings were no different than regular civil trials, and thus must provide a right of public access.

The Third Circuit upheld the district court's decision. The court applied the "experience and logic test," by which "[a] proceeding qualifies for the First Amendment right of public access when 'there has been a tradition of accessibility' to that kind of proceeding, and when 'access plays a significant positive role in the functioning of the particular process in question.'"

Writing for the majority, Judge Sloviter found that civil trials have historically been open to the public. She concluded that arbitrations had a more mixed history: although private arbitrations have generally been closed to the public, government-sponsored arbitrations have not. Because the latter type of proceeding was most relevant, and the benefits of access outweighed any potential drawbacks, Judge Sloviter held that both prongs of the "experience and logic" test were satisfied. As such, there was a right of public access to the arbitrations, and their confidentiality ran afoul of the Constitution.

Judge Fuentes's concurrence emphasized that only the program's confidentiality was problematic; he saw no inherent issues with a judge-run arbitration scheme. Consequently, Judge Fuentes sought to specify which provisions implementing the program were impermissible.

In her dissent, Judge Roth emphasized that arbitrations, both public and especially private, have historically been closed to the public. She also argued that arbitration's principal benefit is its confidentiality, which allows businesses to protect trade secrets and other information, and promotes efficient resolution of issues. Believing the Chancery program to be a "perfect model" for arbitration, Judge Roth expressed concern that the Third Circuit's decision would jeopardize Delaware's status as the "leading state for incorporations."

Delaware Coalition for Open Gov't, Inc. v. Strine, et al., No. 12-3859 (3d Cir. 2013).

Second Circuit Says Injured Investors Lack Standing to Challenge Release of Fair Funds to US Treasury

The US Court of Appeals for the Second Circuit recently held that injured investors, who had already recovered some of their losses due to certain specialist firms' "manipulative tactics," lacked standing to challenge the release to the US Treasury of settlement funds obtained by the Securities and Exchange Commission.

In 2004, the SEC alleged that seven specialist firms had engaged in “interpositioning” and “trading ahead,” two types of conduct by which the firms profited at the expense of their customers. The firms ultimately settled the allegations, and disgorged $157.8 million of profits and an additional $89.4 million in civil penalties, for a total of $247.2 million.

Pursuant to the Sarbanes-Oxley Act, the SEC placed the monies in Fair Funds, which were administered by a law firm tasked with identifying, locating and reimbursing injured investors. The firm was able to match customers for 77.6% of all transactions at issue, but was unable to do so for the remaining 22.4%, leaving $159.8 million in the accounts.

The SEC solicited public comments on the disposition of the undistributed amount. Rejecting proposals from petitioners Robert Martin and Empire Programs, Inc. (Petitioners) and others, the SEC opted to release the leftover Fair Funds to the US Treasury. Petitioners then filed suit seeking review of the SEC’s decision.

The Second Circuit dismissed, finding that Petitioners failed to plead an injury in fact necessary for standing purposes. The court held that any alleged injury was either fully compensated, conjectural or based on alleged violations not covered by the SEC settlements.

Because Petitioners had received payments from the Fair Funds, they had been adequately compensated for injuries arising from the conduct subject to the settlement with the SEC. Moreover, Petitioners failed to prove that they were the injured customers in any of the transactions that the Fair Funds administrator was unable to match. Due to the absence of such proof, the court found that Petitioners alleged a hypothetical injury insufficient to confer standing.

Lastly, the Second Circuit held that any injuries Petitioners suffered in non-covered transactions do not provide them an interest in the remaining funds from a settlement based on covered transactions.

Martin et al. v. US Secs. & Exch. Comm’n, No. 11-3011 (2d Cir. 2013).

BANKING

OCC Publishes Standards on the Use of an Independent Consultant

On November 12, the Office of the Comptroller of the Currency (OCC) published standards governing the use of independent consultants in enforcement actions “involving significant violations of law, fraud, or harm to consumers.”

The standards describe the criteria the OCC will use in determining whether the agency would require a national bank or federal savings association to retain a consultant, as well as the institution’s obligation to exercise due diligence to ensure the consultant has sufficient independence, capacity, resources and expertise. The OCC warned that:

> [t]he use of an independent consultant does not absolve bank management or its board of directors of their responsibility for ensuring the bank complies with OCC enforcement actions and takes all necessary actions to correct identified deficiencies. Moreover, an independent consultant is not a substitute for the supervisory judgment of the OCC. The OCC retains responsibility for supervising national banks and federal savings associations, including overseeing and assessing bank’s compliance with an enforcement action.

Read more.

Agencies Release Final Revisions to Interagency Q&As Regarding Community Reinvestment

On November 15, the federal bank regulatory agencies with responsibility for Community Reinvestment Act (CRA) rulemaking published final revisions to *Interagency Questions and Answers Regarding Community Reinvestment*. The *Questions and Answers* document provides additional guidance to financial institutions and the public on the agencies' CRA regulations.

The revisions focus primarily on community development. Community development activities are considered as part of the CRA performance tests for large institutions, intermediate small institutions, and wholesale and limited purpose institutions. Small institutions may use community development activity to receive consideration toward an outstanding CRA rating. Among other things, the amendments:

- Clarify how the agencies consider community development activities that benefit a broader statewide or regional area that includes an institution's assessment area.
- Provide guidance related to CRA consideration of, and documentation associated with, investments in nationwide funds.
- Clarify the consideration of certain community development services, such as service on a community development organization's board of directors.
- Address the treatment of loans or investments to organizations that, in turn, invest those funds and use only a portion of the income from their investments to support a community development purpose.
- Clarify that community development lending performance is always a factor considered in a large institution's lending test rating.

The final revisions are being issued by the Federal Reserve Board, Federal Deposit Insurance Corporation and Office of the Comptroller of the Currency.

Read more.

EU DEVELOPMENTS

EU Trade Reporting to Begin in February 2014

On November 14, the registration of the first four trade repositories (TRs) under the European Market Infrastructure Regulation (EMIR) took effect. The four registered TRs are:

- DTCC Derivatives Repository Ltd. (DDRL) (United Kingdom)
- Krajowy Depozyt Papierów Wartosciowych S.A. (KDPW) (Poland)
- Regis-TR S.A., (Luxembourg)
- UnaVista Ltd (United Kingdom)

This means that the requirement to report derivatives transactions to trade repositories under EMIR will come into force on February 12, 2014 (90 calendar days after the registration date).

This reporting obligation will apply for all derivatives, including exchange-traded derivatives.

For more information, contact:

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