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CORPORATE & FINANCIAL
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DUE TO THE HOLIDAY, *CORPORATE AND FINANCIAL WEEKLY DIGEST* WILL NOT BE PUBLISHED ON NOVEMBER 29. THE NEXT ISSUE WILL BE DISTRIBUTED ON DECEMBER 6.

SEC/CORPORATE

SEC Chair Mary Jo White Outlines Potential Changes to "Accredited Investor" Definition

On November 14, Securities and Exchange Commission Chair Mary Jo White delivered a letter to Representative Scott Garrett, Chairman of the House of Representatives Subcommittee on Capital Markets and Government-Sponsored Enterprises for the House Financial Services Committee, in which she answered a number of Representative Garrett's questions regarding the status of the SEC's review of the definition of "accredited investor" under Rule 501(a) promulgated under the Securities Act of 1933 (Securities Act). The SEC's review of the accredited investor definition with respect to individuals was mandated by the Dodd–Frank Wall Street Reform and Consumer Protection Act and is currently underway. Any changes to the definition of accredited investor will be closely watched, because such changes will impact which individuals may participate in private offerings of securities conducted under Rule 506 promulgated under the Securities Act, including under new subsection (c), which allows for general solicitation and general advertising.

Although Chairwoman White indicated that the SEC staff's review of the accredited investor definition was not complete, she noted that that SEC's staff is examining whether:

- individuals with certain professional accreditations, including certified public accountants and chartered financial analysts, and experienced financial professionals, including registered investment advisers, brokers, consultants, traders, portfolio managers, analysts, compliance staff, legal counsel and regulators, should be included as accredited investors regardless of whether they satisfy the income and net worth tests;
- individuals with certain educational backgrounds, including finance, accounting or economics, should qualify as accredited investors based solely on such backgrounds;
- expanding the pool of accredited investors would increase liquidity for private market investments;
- ordinary investors relying on the guidance of a registered investment adviser or a qualified broker should be permitted to participate in a Rule 506 offering;
- diminishing the pool of accredited investors would harm US GDP; and
- it is appropriate for the SEC to continue to utilize the current net worth and income tests when determining accredited investor status.

Under the Dodd–Frank Act, the SEC is required to complete its review of the accredited investor definition not later than July 21, 2014, the fourth anniversary of President Obama's signing the Dodd-Frank Act into law.

Read more.

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 Final Rules for Systemically Important Derivatives Clearing Organizations

On November 15, the Commodity Futures Trading Commission finalized rules establishing additional standards for systemically important derivatives clearing organizations (SIDCOs). Designed to be consistent with the Principles for Financial Market Infrastructures (PFMIs), the rules introduce various new procedural and substantive requirements for any derivatives clearing organization (DCO) designated as a SIDCO by the Financial Stability Oversight Council. The requirements relate to governance, financial resources, liquidity resources, system safeguards, special default rules and procedures for uncovered losses, risk management, additional disclosure requirements, efficiency, and recovery and wind-down procedures.

Once implemented, the rules will enable SIDCOs to be recognized as qualifying central counterparties for the purposes of international bank capital standards. Qualifying central counterparty status permits bank and bank affiliate members of the SIDCOs to gain favorable capital treatment in the form of lower capital charges for exposures arising from derivatives cleared through the qualifying central counterparty. Other DCOs may elect to opt-in to the new regulatory requirements in order to gain the same favorable capital treatment.

The final rules are available here.

CFTC Issues Guidance for Swap Execution Facilities

On November 15, the Commodity Futures Trading Commission's Division of Market Oversight (DMO) issued guidance (Guidance) to swap execution facilities (SEFs) and SEF applicants concerning several CFTC regulations relating to SEF registration requirements, consent to SEF jurisdiction, use of proprietary data, member guarantees, emergency action requirements and SEF reporting obligations.

CFTC Regulation 37.3 requires any person operating a facility that offers a trading system or platform on which multiple market participants have the ability to execute or trade swaps with each other to register as a SEF or designated contract market (DCM). The Guidance notes that this includes foreign facilities involved in activities outside the United States when those facilities provide US persons or persons located in the US, including for this purpose personnel and agents of non-U.S. persons that are located in the US, with the ability to trade or execute swaps, either directly or through an intermediary. The Guidance indicates that any such trading platform needs to register as a SEF or DCM, and that DMO is prepared to work with foreign-based platforms and their home country regulators to determine whether alternative compliance arrangements are appropriate.

The Guidance separately addresses the apparent refusal of certain clearing members to consent to the jurisdiction of a SEF. Citing CFTC Regulation 37.700, the Guidance reflects DMO's expectation that a clearing member that guarantees swaps that are intended to be cleared will consent to the jurisdiction of the SEFs on which those swaps have been traded.

The Guidance also addresses SEF participation agreements and rulebooks that require eligible contract participants (ECPs) to consent to the SEF's use for marketing and business purposes of market, proprietary or personal data it has collected from the ECP. The Guidance states that such provisions are inconsistent with CFTC Regulation 37.7 and that SEFs may not condition access based upon an ECP's consent to use data or information.

In answering questions regarding whether a SEF may require a member of the SEF to guarantee trades executed by the member for its own account or the account of other market participants, the Guidance states that a guarantee from a clearing member is required to satisfy CFTC Regulation 37.700, but that no additional guarantee is required.

CFTC Regulation 37.800 requires a SEF to adopt rules that may be exercised in an "emergency," as defined in CFTC Regulation 40.1(h). The Guidance provides that the definition of "emergency" in a SEF rulebook must be consistent with, and not broader than, the CFTC's definition.

Finally, the Guidance addresses SEF reporting obligations. Specifically, the Guidance indicates that a SEF must include the legal entity identifier of the SEF in the required "execution venue" field when the SEF files reports with a swap data repository pursuant to Parts 43 and 45 of the CFTC's Regulations.

The division's guidance is available here.

CFTC Provides Relief for Intended-to-Be-Cleared Swaps

The Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight has issued No-Action Letter 13-70 providing relief to swap dealers (SDs) and major swap participants (MSPs) from (1) trading relationship documentation obligations under CFTC regulation 23.504, and (2) certain external business conduct rules, in each case with respect to swaps that are intended to be cleared (ITBC swaps). The relief is similar to the relief provided by CFTC No-Action Letter No. 13-33, but the conditions for that relief have been significantly modified in light of changed market circumstances and improved processing of swaps from execution to clearing. As a result, No-Action Letter 13-33 has been superseded and is no longer valid.

No-Action Letter 13-70 identifies four different situations in which relief is available and itemizes the business conduct standards covered by the letter in Tables 1 and 2. The specific relief afforded in the context of a particular ITBC swap depends on relevant circumstances and conditions, including whether or not the SD or MSP knows the counterparty's identity prior to execution, whether or not the swap is executed on or subject to the rules of a swap execution facility or designated contract market, and whether or not the swap is currently cleared by a derivatives clearing organization (DCO) or subject to a mandatory clearing determination by the CFTC. In all cases, the SD or MSP must be a clearing member of the DCO where the ITBC swap will be submitted or has entered into an agreement with a DCO clearing member that clears the same types of swaps as the ITBC swap, and the SD or MSP cannot require the counterparty or its clearing futures commission merchant to enter into a breakage agreement or similar agreement as a condition to executing the swap.

CFTC Letter No. 13-70 is available here.

CFTC Announces Weekly Swaps Report

On November 20, the Commodity Futures Trading Commission announced the initiation of the CFTC Weekly Swaps Report. Modeled on the CFTC Commitments of Traders report, the Weekly Swaps Report will be published each Wednesday at 3:30 p.m. and will provide a detailed view of the swaps marketplace. The report provides three views of the swaps market: the gross notional outstanding, weekly transactions measured by dollar volume and the weekly transactions measured by transaction ticket volume. The report will detail breakdowns of the swaps market for each asset class by product type, currency, tenor, participant type, and whether swaps are cleared or uncleared.

The Weekly Swaps Report is available here.

Futures Industry Releases Insurance Study

On November 15, the Chicago Mercantile Exchange Group, Futures Industry Association, Institute for Financial Markets, and National Futures Association released a study on the economic feasibility of adopting an insurance regime for the United States futures industry. The study assessed the economic impacts of four proposals for providing customer asset protection insurance (CAPI) for losses suffered by customers of under-segregated

futures commission merchants (FCMs). The study analyzed both private, voluntary CAPI and government-mandated, universal CAPI proposals.

The study evaluated three private, voluntary CAPI scenarios, summarily rejecting two of those alternatives based on cost. The remaining scenario would provide CAPI to customers of FCMs that elect to participate in a group insurance plan offered by an FCM captive insurance company, which the study calls the Futures Industry Customer Asset Protection Insurance Company (FICAP). FICAP, which would be funded by member contributions and partially backed by reinsurance, would provide $300 million of initial coverage, with the first $50 million in losses covered by participating FCMs, and the remaining $250 million covered by reinsurance. The study estimated costs of such a program to be between $18 and $27 million per year, but noted that the final cost would be dependent on underwriting, the number of participating FCMs, and negotiations between FCMs and the insurance companies. The study concluded that there is a willingness and interest by reinsurers to offer CAPI through a FICAP program.

The study also analyzed a fourth scenario involving a government-mandated and universal CAPI coverage plan for all US futures customers. Modeled after the Securities Investor Protection Corporation, a Futures Investor and Customer Protection Corporation (FICPC) would provide up to $250,000 to all customers of every US FCM to cover losses arising from the failure of one or more under-segregated FCMs. FICPC would be funded by mandatory FCM payments until it reached a target funding level of $2.5 billion. The study determined it would take approximately 54 years to reach this target level. The study concluded that a FICPC fund would be significantly under-funded in meeting its target level, and that the only way to offer credible assurance to futures customers that their losses would be covered would be to provide a taxpayer-backed government backstop.

The study is available here.

Chicago Mercantile Exchange Issues Advisory Notice on Wash Trades

On November 19, the CME Group Exchanges issued Market Regulation Advisory Notice RA0913-5R regarding the prohibition on wash trades. The Advisory Notice defines a “wash trade” as “a form of fictitious trade in which a transaction or a series of transactions give the appearance that bona fide purchases and sales have been made, but where the trades have been entered into without the intent to take a bona fide market position or without the intent to execute bona fide transactions subject to market risk or price competition.”

The Advisory Notice notes that intent may be inferred from evidence of prearrangement or evidence that trades were structured, entered or executed in a manner that the parties knew or should have known would result in a wash trade. The Advisory Notice places a duty on market participants, including account executives and floor brokers, to inquire about the propriety of simultaneous buy and sell orders that they receive for execution. Participants must monitor trading and minimize the potential for and occurrence of wash results.

With regard to transactions on Globex, the Advisory Notice states that there is a significant potential for regulatory exposure when trades self-match and, while unintended and incidental buy and sell order matching is generally not considered a wash trade, any self-matching on a more than incidental basis in the context of the trader, trading group or algorithm’s activity may be considered a wash trade that violates exchange rules. The Advisory also discusses more specific situations that further address the extent of wash trade rules for firms with independent proprietary traders and certain types of trades.

CME Group Exchanges provide a voluntary Self-Match Prevention (SMP) functionality that can be employed to block the matching of buy and sell orders that are submitted to Globex with the same SMP ID in the order message and within the same Executing Firm. While utilizing the SMP functionality is not mandatory, the Advisory Notice encourages market participants to review their operations and the Advisory Notice and, where appropriate, take steps to minimize the potential for wash trades through the use of SMP functionality or by alternative means.

The Advisory Notice is available here.

LITIGATION

Federal Judge Reaffirms Decision to Narrow SEC's Adviser Act Claims Against Hedge Fund

Last week, a Georgia federal judge reaffirmed a decision to narrow two claims in a civil enforcement action accusing two hedge fund managers and their firms of defrauding investors. Paul T. Mannion Jr. and Andrew S. Reckles are principals and co-owners of PEF Advisors Ltd. and PEF Advisors LLC, which are investment advisers to two feeder funds for Palisades Master Fund, L.P. (Palisades). The Securities and Exchange Commission alleges that in August, September and October 2005, defendants reported monthly "net asset values" with inflated values of certain assets held by Palisades, and that in July and August 2005, defendants personally exercised stock warrants belonging to Palisades. According to the SEC, defendants' actions violated Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, and subsections (1) and (2) of Section 206 of the Investment Advisers Act of 1940. In 2011, the court held that Section 206 of the Advisers Act only applied to the extent defendants' conduct was directed at Palisades, rather than individual investors and limited defendants' liability for these claims to the amount of the increased management fees they received as a result of the alleged overvaluations. In April 2013, the SEC filed a motion for reconsideration, arguing that the court should not have limited the scope of the valuation claim to defendants' inflated management fees. On November 12, the court reaffirmed its decision to narrow the claims, reasoning that Section 206 requires proof of a "material" misrepresentation or omission to a "client," and that the "client" was Palisades itself, not Palisades' individual investors. Although a fiduciary relationship can be inferred where a hedge fund manager directly advises an investor, the court held that the SEC did not plead that defendants advised investors.

Securities and Exchange Commission v. *Mannion et. al.,* No. 10-cv-03374 (N.D. Ga. Nov. 12, 2013).

Delaware Chancery Court Permits Shareholder to Bring Fiduciary Claim for Board's Violation of a Stock Incentive Plan

On November 8, the Delaware Chancery Court denied a motion to dismiss a derivative action brought by a shareholder of Healthways, Inc. against the company's president, Ben Leedle, Jr., and the board of directors for approving stock option grants to Mr. Leedle in excess of the amount permitted by the shareholder-approved Stock Incentive Plan (the Plan).The shareholder claimed that the board had breached its fiduciary duties of loyalty and care by granting excess stock options to Mr. Leedle and by causing Healthways to issue a materially misleading and false 2012 proxy statement. The shareholder also alleged that Mr. Leedle breached his fiduciary duties by accepting the excessive stock options, and that he was unjustly enriched. The shareholder sought, among other things, a rescission of any excessive stock options. Defendants moved to dismiss the complaint in its entirety, arguing that the shareholder improperly failed to comply with the pre-suit demand requirement, that the stock options grant was permissible under the Plan, and that even if pre-suit demand were excused, the shareholder failed to state a claim upon which relief can be granted. Although the court disagreed with the shareholder's argument that the Plan prohibited performance awards in the form of stock options, it nonetheless concluded that there were sufficient allegations in the complaint that the board had violated the unambiguous provisions of the Plan, and therefore pre-suit demand was excused. The court also concluded that it is reasonably conceivable that the board knowingly or intentionally caused Healthways to issue a proxy statement containing misleading assertions that Mr. Leedle's stock option grants were in conformance with the Plan. Lastly, the court declined to dismiss the breach of fiduciary duty and unjust enrichment claims against Mr. Leedle.

Pfeiffer v. Leedle, C.A. No. 7831-VCP (Del. Ch. Nov. 8, 2013).

BANKING

OCC and FDIC Issue Guidance on Deposit Advance Loans

On November 21, the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) issued final supervisory "guidance" to supervised financial institutions that offer or may consider offering deposit advance products. Deposit advance products

> are a type of small-dollar, short-term credit product that some depository institutions offer to customers maintaining a deposit account, reloadable prepaid card, or similar deposit-related vehicle. The customer takes out a loan, which is to be repaid from the proceeds of his next direct deposit. Deposit advance products share a number of characteristics seen in traditional payday loans, including high fees; short, lump-sum repayment terms; and inadequate attention to the consumer's ability to repay.

FDIC Chairman Martin J. Gruenberg said, "The final supervisory guidance released today aims to alert financial institutions to the risks posed by certain deposit advance products and to encourage institutions to meet the demand for small-dollar loans through affordable products that are prudently underwritten and designed."

Comptroller of the Currency Thomas J. Curry said:

> …[D]eposit advance products share a number of characteristics with traditional payday loans, including high fees, short repayment periods, and inadequate attention to the ability to repay. As such, these products can trap customers in a cycle of high-cost debt that they are unable to repay. As a result, they pose significant safety and soundness and consumer protection risks. Banks must understand and manage those risks, and this guidance clarifies our expectations for doing so.

"The guidance is intended to ensure that banks are aware of the credit, reputational, operational and compliance risks associated with deposit advance products and have taken steps to mitigate these risks effectively."

The final guidance issued is substantially the same as the proposal issued by the OCC on April 25. Amendments to the proposed guidance clarify certain provisions in response to concerns raised during the public comment period. "Specifically, language was added to clarify that eligibility and underwriting expectations do not require the use of credit reports and to emphasize that the guidance applies to all deposit advance products regardless of how the extension of credit is offered."

Read more.

Federal Reserve and CFPB Announce New Thresholds for Exempt Consumer Credit and Lease Transactions

On November 20, the Federal Reserve Board and the Consumer Financial Protection Bureau (CFPB) announced they are increasing the dollar thresholds in Regulation Z (Truth in Lending) and Regulation M (Consumer Leasing) for exempt consumer credit and lease transactions. Transactions at or below the thresholds are subject to the protections of the regulations. The adjustments to the thresholds reflect the annual percentage increase in the Consumer Price Index for Urban Wage Earners and Clerical Workers as of June 1, 2013 and will take effect on January 1, 2014. These increases are consistent with amendments to the Truth in Lending and Consumer Leasing laws made by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Based on the adjustments announced today, the protections of the Truth in Lending and Consumer Leasing acts generally will apply to consumer credit transactions and consumer leases of $53,500 or less in 2014—an increase of $500 from 2013. However, private education loans and loans secured by real property (such as mortgages) are subject to the Truth in Lending Act regardless of the amount of the loan. The agencies made a joint issuance because although the Dodd-Frank Act generally transferred rulemaking authority under the Truth in Lending Act and the Consumer Leasing Act to the CFPB, the Federal Reserve Board retains authority to issue rules for certain motor vehicle dealers.

Read more.

Agencies Release a Regulatory Capital Estimation Tool for Community Banks

The federal bank regulatory agencies on November 19 released an estimation tool to help community banks understand the potential effects of the recently revised regulatory capital framework on their capital ratios. The revised framework implements the Basel III regulatory capital reforms and certain changes required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. In July, the Federal Reserve Board and Office of

the Comptroller of the Currency approved the revised capital framework as final rules, and the Federal Deposit Insurance Corporation approved the revised capital framework as an interim final rule. The final rules and interim final rule are substantively identical.

The agencies also stated that "[t]he estimation tool is not part of the revised capital framework and not a component of regulatory reporting. Results from the tool are simplified estimates that may not precisely reflect banks' actual capital ratios under the framework. Additionally, banks should be aware that the estimation tool requires certain manual inputs that could have meaningful effects on results and should reference the revised capital framework when using the estimation tool."

The estimation tool is available here.

For more information, contact:

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