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SEC/CORPORATE

SEC Roundtable Discusses Cybersecurity Threats and Protections Against Cyberattacks

On March 26, the Securities and Exchange Commission hosted a roundtable discussion on various cybersecurity topics. Participants at the roundtable included representatives from the federal government, self-regulatory organizations, investment advisers, other financial institutions, academics and law firms. The roundtable underscores the SEC's increased focus on cybersecurity-related issues for SEC-registered entities.

Among other things, panelists discussed the growing frequency and sophistication of cyberattacks and their serious threat to capital markets and the overall market economy. Panelists acknowledged that preventing and responding to cyberattacks was difficult, given the evolving nature of the threat and technological landscape. The Cybersecurity Framework developed by the National Institute of Standards and Technology (NIST) provides guidelines on how to build cybersecurity infrastructure. The SEC has also begun to conduct cybersecurity exams for broker-dealers, as announced in the SEC's Examination Priorities for 2014.

For information on the roundtable, click here.

The NIST Cybersecurity Framework is available here.

The SEC Examination Priorities for 2014 are available here.

BROKER DEALER

Proposed Changes to FINRA Classification of Hybrid Securities for Trade Reporting Purposes

On March 26, the comment period ended for a Financial Industry Regulatory Authority, Inc. proposed rule change to adopt an interpretation to clarify the classification of a hybrid security with both debt- and equity-like features for trade reporting purposes. Generally, under FINRA Rule 6622, over-the-counter (OTC) transactions in "OTC Equity Securities" must be reported to the OTC Reporting Facility (ORF), while FINRA Rule 6700 Series requires that transactions in "TRACE-Eligible Securities" be reported to the Trade Reporting and Compliance Engine (TRACE). FINRA proposed including depositary shares in OTC Equity Securities and including capital trust securities and trust preferred securities not listed on a national securities exchange in TRACE-Eligible Securities. In response to a Securities Industry and Financial Markets Association (SIFMA) comment letter, FINRA amended the rule to include depositary shares or preferred securities with a liquidation preference of $1,000 or more and not listed on a national security exchange in TRACE-Eligible Securities and not in OTC Equity Securities. The proposed changes do not change the text of the rule.

The original *Federal Register* notice is available here.

The *Federal Register* notice of the amendment is available here.

FINRA Proposes to Amend Rule 4210

The Financial Industry Regulatory Authority, Inc. requested comments on amendments to Rule 4210 to establish margin requirements for To Be Announced (TBA) market transactions. The TBA market is where most agency mortgage-backed security (MBS) trading takes place. Most transactions are characterized with forward settlements up to six months past the trade date. The proposed rule change applies to TBA transactions, including adjustable rate mortgage (ARM) transactions, specified pool transactions and collateralized mortgage obligation (CMO) transactions, with forward settlement dates. FINRA members engaging in such transactions with any counterparty must determine risk limits unless the transactions are either cleared or with an exempt counterparty or central bank counterparty. For transactions with non-exempt accounts that meet a $250,000 *de minimis* amount, FINRA members must collect variation margin and maintenance margin equal to 2 percent of the market value of the securities. FINRA members must also report concentrated credit exposures and may be prohibited from entering into any new transactions if net capital deductions over a five business day period: (1) exceed 5 percent of the member's tentative net capital for a single account (or commonly controlled accounts) or (2) exceed 25 percent of the member's tentative net capital for all accounts. Exempt account determination depends on the beneficial ownership of the account, and sub-accounts of investment advisers must meet individual margin requirements.

The Proposed Rules are available here.

FINRA's notice to members is available here.

CFTC

CFTC Extends Expiration of MTF Relief

On February 12, the Commodity Futures Trading Commission's Division of Market Oversight (DMO) issued relief from registration as a swap execution facility (SEF) to multilateral trading facilities (MTFs) regulated within the European Union. To qualify for such relief, an MTF was required to submit a request to DMO that satisfied the conditions set forth in CFTC Letter No. 14-16. DMO simultaneously issued CFTC Letter No. 14-15, which provided temporary no-action relief to such an MTF until the earlier of March 24, 2014, or DMO's issuance of a letter granting the MTF's relief request pursuant to CFTC Letter No. 14-16. A Katten Client Advisory covering CFTC Letters Nos. 14-15 and 14-16 is available here.

DMO has now issued CFTC Letter No. 14-31, which provides that DMO and the Division of Swap Dealer and Intermediary Oversight intend to issue yet another no-action letter to supersede and replace No-Action Letter 14-16. (As of March 21, no MTF had submitted a formal relief request to DMO pursuant to CFTC Letter No. 14-16.) The replacement no-action letter will provide similar long-term relief to MTFs, but will contain certain clarifications and other amendments. In the interim, CFTC Letter No. 14-31 extends temporary no-action relief from SEF registration to an MTF until the earlier of May 14, 2014, or DMO's issuance of a letter granting an MTF's relief request pursuant to the replacement no-action letter.

CFTC Letter No. 14-31 is available here.

CFTC Requests Public Comment on ICE Swap Trade Packaged Transaction Rule

ICE Swap Trade, LLC, a swap execution facility temporarily registered with the Commodity Futures Trading Commission, recently self-certified amendments to its rules (ICE Rules) to allow market participants to execute "packaged transactions" as block trades. To qualify as a "packaged transaction" under the ICE Rules, a transaction must consist of two or more interrelated components with at least one component subject to the trade execution requirement in Section 2(h)(8) of the Commodity Exchange Act.

The CFTC's Division of Market Oversight (DMO) issued a stay of ICE's self-certification on February 26, and the CFTC is now requesting public comments on the rule amendments. Among other things, the CFTC has asked for comments on current market conventions regarding package transactions. The CFTC has also asked for comment on whether package transactions should be subject to the minimum notional or principal amounts required for block trades in Part 43 to the CFTC's Regulations. Public comments must be submitted by April 23, 2014.

ICE's self-certification is available here.

More information regarding the CFTC's request for public comment is available here.

LITIGATION

Money Manager Sues SEC to Stop Administrative Action in $1.5 Billion CDO Case

A money manager and his firm recently sued the Securities and Exchange Commission claiming that the agency violated their constitutional rights by bringing an administrative proceeding for securities claims in connection with several collateralized debt obligation transactions (CDOs). Wing F. Chau and his firm Harding Advisory LLC (Plaintiffs) assert that the SEC deprived them of significant procedural protections by not bringing a lawsuit in federal court.

In October 2013, the SEC commenced an administrative proceeding against Plaintiffs, alleging that they committed fraud in connection with the creation and marketing of various CDOs, including a $1.5 billion CDO known as Octans I for which Harding served as collateral manager. The SEC alleged that Plaintiffs defrauded investors by failing to reveal that a hedge fund, whose interests were not aligned with those of investors, had a role in choosing the collateral for Octans I.

In filing suit against the SEC, Plaintiffs claim that the SEC "intentionally and strategically singled out the Plaintiffs by bringing [the] case as an [administrative proceeding] and effectively tying the Plaintiffs' hands behind their backs." Plaintiffs allege that the SEC engaged in disparate and unlawful treatment of Plaintiffs, citing what Plaintiffs contend are several factually similar CDO cases that were tried in federal court. Plaintiffs seek a declaration that the SEC's decision to initiate and pursue administrative proceedings against them violates their equal protection rights, and seek a permanent injunction enjoining the SEC from pursuing the administrative action.

Chau v. SEC, No. 14-CV-1903 (S.D.N.Y. Mar. 18, 2014).

Texas District Court Denies Class Certification in IPO Securities Suit

The US District Court for the Northern District of Texas recently denied class certification for a securities action arising from alleged false and misleading statements in Kosmos Energy Limited's initial public offering.

Investors sued Kosmos under the Securities Act of 1933, alleging that offering documents contained misrepresentations about the performance and expected production of an offshore oilfield in Ghana called "Jubilee Field," which investors claim resulted in "hundreds of millions of dollars" in damages. The proposed Lead Plaintiff, a pension plan, filed a motion for class certification, arguing that it met certification requirements under Rule 23 and the Private Securities Litigation Reform Act. Defendants opposed the motion, arguing among other things that the Lead Plaintiff failed to possess a sufficient level of knowledge and understanding of the case. Defendants pointed to deposition testimony of the pension plan's representative, which they argued revealed that the representative had never even seen Kosmos' Registration Statement, the central document in the case, and that the representative was generally unfamiliar with the theories of the case. The District Court agreed with the Defendants and found that the Lead Plaintiff demonstrated insufficient knowledge of the case to act as the class representative. In denying class certification, the District Court emphasized that plaintiffs seeking class certification must produce "actual, credible evidence that proposed class representatives are informed, able individuals, who are themselves – not the lawyers – actually directing the litigation."

In re Kosmos Energy Ltd. Securities Litigation, No. 3:12-CV-373-B (N.D. Tex Mar. 19, 2014).

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LITIGATION

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