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SEC/CORPORATE

ISS Announces Launch of QuickScore 3.0

On October 29, Institutional Shareholder Services (ISS), a leading proxy advisory firm, announced that on November 24 it will launch the third generation of its QuickScore governance risk rating system, QuickScore 3.0.

QuickScore 3.0, which updates QuickScore 2.0 (discussed previously in the Corporate & Financial Weekly Digest), will include additional factors upon which a company's QuickScore is based, including whether: (1) the company discloses a policy requiring annual performance evaluation of the board; (2) the company has a controlling shareholder; (3) the company's board has recently taken any action that materially reduces shareholder rights; and (4) the company has a sunset provision with regards to the company's unequal voting rights, if any exist. Additionally, QuickScore 3.0 will enhance ISS's research reports by including data on a company's historical QuickScore ratings and changes in data used to determine a company's QuickScore, as well as icons reflecting trends in a company's governance practices.

As with past iterations of QuickScore, QuickScore 3.0 will continue to serve as ISS's assessment of a company's governance risk against other companies based upon four "pillars" of governance: (1) Board Structure; (2) Shareholder Rights & Takeover Defenses (formerly the "Shareholder Rights" pillar); (3) Compensation/ Remuneration; and (4) Audit & Risk Oversight (formerly the "Audit" pillar). Companies receive a rating for each "pillar" and one overall QuickScore rating. Respective weights given to the four pillars in determining the overall QuickScore, and the respective weights given to factors within any pillar used to determine the rating for that pillar, will not be disclosed, consistent with past versions of QuickScore.

Companies will have from 9:00 a.m. ET on November 3 until 8:00 p.m. ET on November 14 to review ISS's data and submit any updates or corrections through ISS's data review and verification website, for purposes of updated ratings based upon QuickScore 3.0, to be released by ISS on November 24.

BROKER-DEALER

SEC Provides Relief to GSEC From Rule 204 Close-Out Requirements

On October 27, the Securities and Exchange Commission's Division of Trading and Markets (Division) issued no-action relief to Goldman Sachs Execution & Clearing (GSEC) relating to the close-out requirements of Rule 204. In general, in order for a broker-dealer to satisfy its close-out requirements under Rule 204, it must purchase or borrow sufficient shares to satisfy its fails to deliver in full and must have a net flat or net long position on its books and records as of the end of the applicable close-out date. This latter requirement was problematic for GSEC because some of its clearing clients typically engaged in so-called "subsequent activity" (e.g., effected transactions away from GSEC at or near the end of the trading day).

The Division stated it would not recommend enforcement action against GSEC under Rule 204 regarding subsequent activity if, with respect to clients to whom GSEC is not permitted to delegate close-out responsibility under Rule 204 (such as market makers), GSEC: (1) identified the clients that caused or contributed to its net fail

to deliver position and determined the number of shares attributable to each such client using a reasonably designed and consistently applied method, and (2) required these clients to end the close-out date as a "net purchaser" of the relevant number of shares. If the clients fail to take this step, GSEC must, on the day after the close-out date, buy in the client for the amount of shares that, when added to the client's net trading activity on the applicable close-out date, would have made the client a “net purchaser” of the relevant shares on the close-out date. In connection with this relief, GSEC agreed that it would not list securities in which it had a close-out obligation on its easy-to-borrow list.

The letter to GSEC and accompanying request for relief by GSEC are available here.

CFTC

CFTC Extends Relief to FCMs from Certain Commingling Requirements

On October 30, the Commodity Futures Trading Commission’s Division of Swap Dealer and Intermediary Oversight (DSIO) extended indefinitely the relief previously granted in CFTC No-Action Letters Nos. 14-02, 14-45 and 14-88, as reported in the June 27 edition of the *Corporate Financial Weekly Digest*.

CFTC Regulations 1.20, 22.2 and 30.7 prohibit the commingling of customer segregated funds, cleared swaps customer collateral and customer secured amount funds. The CFTC had stated that the prohibition on the commingling of customer funds would not prevent a customer from meeting margin calls for multiple customer account origins with a single payment provided that, among other conditions, the futures commission merchant (FCM) initially receives the margin payment into the customer segregated funds account required under Regulation 1.20.

The earlier letters provided time-limited relief with respect to compliance with this interpretation. An FCM relying on this relief is required to hold sufficient funds in its segregated funds, cleared swaps customer collateral and secured amount accounts to meet the net liquidating equities of all customers in each account origin at all times. This no-action position is further conditioned upon an FCM receiving customer margin deposits only in Section 4d(a)(2) Funds, Part 30 Secured Funds or Cleared Swaps Funds accounts. In granting the current relief, DSIO staff indicated that it anticipates recommending that the CFTC propose amendments to its rules to address the receipt of customer funds by an FCM. The current relief extends until the CFTC takes final action with respect to such amendments.

CFTC Letter No. 14-131 is available here.

LITIGATION

District Court Holds Video Game Company’s Optimistic Statements Are Not Actionable

The US District Court for the Northern District of California recently dismissed a securities fraud class action against Electronic Arts, Inc. (EA) and named officers and directors, holding that optimistic statements about EA’s ability to transition to next-generation gaming consoles were mere puffery.

In early 2013, EA began development on a sequel to one of its most profitable titles, *Battlefield 4*, and announced that the new game would be playable on next-generation gaming consoles, Sony PlayStation 4 and Microsoft Xbox One. During the development and release period—between May 2013 and December 2013—EA representatives made positive statements about *Battlefield 4*, emphasizing EA’s ability to transition with the next-generation consoles, contrary to what plaintiffs describe as EA’s prior history of disastrous game-launch and console-transition failures. After an October 29 launch, the company received complaints from customers and negative reviews from critics regarding the game’s playability. EA’s stock price dropped from a high of $27.99 to $21.01 on December 5, 2013. In late 2013 and early 2014, plaintiffs brought separate actions alleging securities fraud, which were consolidated in February 2014.

The court examined eight statements identified by plaintiffs as materially false or misleading and held that the statements emphasizing that EA was prepared to make the console transition, or that EA had “de-risked” the

process, were corporate opinion or mere puffery. Thus, the court granted EA's motion to dismiss because all of the alleged misstatements were inactionable opinion.

Kelly v. Electronic Arts, Inc., No. 13-05837 SI (N.D. Ca. Oct. 20, 2014).

Securities Class Action Dismissed Where Information Was Publicly Available

The US District Court for the Western District of Washington recently dismissed a securities fraud class action against Zillow, Inc. and named officers and directors, holding that the material omissions plaintiff alleged were already known to the market.

Zillow is an online real estate marketing company that derives revenue from online advertisements, including a subscription service for local real estate agents. Subscribers are referred to as Zillow's Premier Agents. In early 2012, Zillow announced that it would implement a new pricing model for its Premier Agents. Plaintiffs alleged that Zillow withheld material information about difficulties encountered in its new pricing model. Among other claims, plaintiffs alleged that Zillow should have disclosed its Static Average Revenue Per Customer (ARPU), which they claimed would have illustrated whether Zillow was successfully implementing the new pricing plan. According to plaintiffs, when Zillow released its ARPU in early November 2012, it "shocked the market" for Zillow stock. Plaintiffs filed a complaint alleging securities fraud in late November 2012.

The court held that Zillow's failure to disclose that ARPU was flat was not an actionable omission because analysts in the market had already estimated that Zillow's ARPU was flat or decreasing. In addition to analyst estimates, one of the named defendants disclosed that ARPU was down. Because the information was credibly available in the market before the November release, the court found that an earlier release of ARPU would not have affected the total mix of information available in the market, and granted Zillow's motion to dismiss.

Reinschmidt v. Zillow, Inc., No. C12-2084 (W.D. Wash. Oct. 20, 2014).

BANKING

OCC Revises Process for Managing Matters Requiring Attention

The Office of the Comptroller of the Currency (OCC) on October 30 published revised policy and procedures for how it manages Matters Requiring Attention (MRAs) resulting from its examination of supervised institutions. MRAs communicate specific supervisory concerns identified during examinations in writing to boards and management teams of regulated institutions. MRAs must receive timely and effective corrective action by bank management and follow-up by OCC examiners. The bulletin released yesterday by the OCC highlights changes to policy and procedures regarding MRAs, which have been incorporated into the "Bank Supervision Process," "Large Bank Supervision," "Community Bank Supervision," and "Federal Branches and Agencies Supervision" booklets of the *Comptroller's Handbook* and internal guidance.

The principles contained in the MRA guidance apply to examinations of all national banks, federal savings associations, and federal branches and agencies, regardless of size.

Agencies Request Comment on Proposed Flood Insurance Rule

Five federal regulatory agencies on October 24 announced the approval of a joint notice of proposed rulemaking to amend regulations pertaining to loans secured by property located in special flood hazard areas. The proposed rule would implement provisions of the Homeowner Flood Insurance Affordability Act of 2014 (HFIAA) relating to escrowing flood insurance payments and the exemption of certain detached structures from the mandatory flood insurance purchase requirement. HFIAA amends the escrow provisions of the Biggert-Waters Flood Insurance Reform Act of 2012 (the Biggert-Waters Act).

In accordance with HFIAA, the proposed rule would require regulated lending institutions to escrow premiums and fees for flood insurance for loans secured by residential improved real estate or mobile homes that are made, increased, extended or renewed on or after January 1, 2016, unless the regulated lending institution or a loan qualifies for a statutory exception. In addition, the proposed rule would require institutions to provide borrowers of

residential loans outstanding on January 1, 2016, the option to escrow flood insurance premiums and fees. The proposal includes new and revised sample notice forms and clauses concerning the escrow requirement and the option to escrow. Finally, the proposal would eliminate the requirement to purchase flood insurance for a structure that is a part of a residential property located in a special flood hazard area if that structure is detached from the primary residential structure and does not also serve as a residence. However, under HFIAA, lenders may nevertheless require flood insurance on the detached structures to protect the collateral securing the mortgage. The proposed rule is being issued by the Board of Governors of the Federal Reserve System, the Farm Credit Administration, the Federal Deposit Insurance Corporation, the National Credit Union Administration, and the Office of the Comptroller of the Currency.

Comments will be due 60 days after the rule is published in the *Federal Register*.

Six Federal Agencies Jointly Approve Final Risk Retention Rule

Six federal agencies approved on October 22 a final rule requiring sponsors of securitization transactions to retain risk in those transactions. The final rule implements the risk retention requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The final rule is being issued jointly by the Board of Governors of the Federal Reserve System, the Department of Housing and Urban Development, the Federal Deposit Insurance Corporation, the Federal Housing Finance Agency, the Office of the Comptroller of the Currency, and the Securities and Exchange Commission. As provided under the Dodd-Frank Act, the Secretary of the Treasury, as chairperson of the Financial Stability Oversight Council, played a coordinating role in the joint agency rulemaking. The final rule largely retains the risk retention framework contained in the proposal issued by the agencies in August 2013 and generally requires sponsors of asset-backed securities (ABS) to retain not less than five percent of the credit risk of the assets collateralizing the ABS issuance. The rule also sets forth prohibitions on transferring or hedging the credit risk that the sponsor is required to retain.

As required by the Dodd-Frank Act, the final rule defines a “qualified residential mortgage” (QRM) and exempts securitizations of QRMs from the risk retention requirement. The final rule aligns the QRM definition with that of a qualified mortgage as defined by the Consumer Financial Protection Bureau. The final rule also requires the agencies to review the definition of QRM no later than four years after the effective date of the rule with respect to the securitization of residential mortgages and every five years thereafter, and allows each agency to request a review of the definition at any time. The final rule also does not require any retention for securitizations of commercial loans, commercial mortgages, or automobile loans if they meet specific standards for high quality underwriting.

The final rule will be effective one year after publication in the Federal Register for residential mortgage-backed securitizations and two years after publication for all other securitization types.

UK DEVELOPMENTS

UK Regulators Launch Review of Fixed Income, Foreign Exchange and Commodities Markets

The UK Treasury, the Bank of England and the UK Financial Conduct Authority have jointly launched a Fair and Effective Markets Review (FEMR) of the fixed income, foreign exchange and commodities (FICC) markets in the UK. According to the UK regulators, the FEMR consultation is motivated by a need to ensure that the FICC markets in the UK are “fair and effective” and that confidence is restored in these markets following recent allegations of wrongdoing. The consultation document notes that, although the FICC markets are characterized by sophisticated participants, events in these markets have consequences for the wider economy and therefore whether the markets are “fair and effective” must be assessed in light of these broader economic interests.

For these purposes, the UK regulators propose to define an “effective” FICC market as one that enables market participants to trade at competitive prices while allowing the ultimate end-users to undertake investment, funding, risk transfer and other transactions in a predictable fashion, underpinned by robust infrastructure. A FICC market will be “fair” to the extent that it has clear and consistently applied standards of market practice, demonstrates sufficient transparency and open access, allows market participants to compete on the basis of merit, and provides confidence that participants will behave with integrity. With these proposed definitions in mind, responders have been asked in the FEMR consultation to identify where FICC markets may currently not be “fair”

or "efficient" and to propose additional steps that may be required to help remedy these deficiencies. Responders have also been urged to identify existing regulatory, technical or organizational developments that have, or are likely to have, addressed deficiencies in order to minimize duplication of efforts.

The FEMR consultation document is available here. The consultation period closes on January 30, 2015.

EU DEVELOPMENTS

Updated EMIR Q&A Published by ESMA

The European Securities and Markets Authority (ESMA) published the eleventh version of its "Questions and Answers" on EMIR implementation (EMIR Q&A) on October 24. The updated EMIR Q&A responds principally to questions that have been raised in respect of meeting applicable trade repository (TR) reporting requirements.

Of note, ESMA has now clarified that any third country firm not originally subject to EMIR trade reporting obligations that subsequently becomes a financial counterparty subject to EMIR—for example as a consequence of relocation to the EU or because it is an investment fund managed by an alternative investment fund manager that becomes authorized under the EU Alternative Investment Fund Managers Directive—must comply with the EMIR reporting obligation in respect of all outstanding derivatives contracts. In addition, the updated EMIR Q&A distinguishes between reporting of block trades by investment firms that are subsequently allocated—where the block trade and the subsequent allocations must be reported—and block trades concluded by a fund manager not subject to a reporting obligation. In the latter case, if the block trade is allocated to the manager's individual funds on the trade date, only the allocations need to be reported, whereas if the block trade is not allocated on the trade date, the block itself must be reported with the fund manager as counterparty.

The updated EMIR Q&A also addresses certain outstanding operational issues. For example, ESMA has now set out its recommended approach for establishing the responsibility to generate a unique trade identifier as well as a method for determining which party is the "seller" and which the "buyer" on physically delivered foreign exchange forwards and swaps.

The updated EMIR Q&A is available here.

European Commission Adopts First Equivalence Decisions for Non-EU CCPs

On October 30, the European Commission (EC) adopted its first equivalence decision for the regulatory regimes of central counterparties (CCPs) located in four jurisdictions: Australia, Hong Kong, Japan and Singapore.

Under the European Market Infrastructure Regulation (EMIR), any CCP clearing for an EU clearing member or trading venue, must either be authorized or recognized by the European Securities and Markets Authority (ESMA). Only CCPs located in the EU can become authorized by ESMA. Before a non-EU CCP can become recognized by ESMA, the EC must have made a determination that the regulatory framework of the CCP's home jurisdiction is equivalent to those of EU CCPs under EMIR. The non-EU CCP, however, remains subject to regulation and supervision only in its home jurisdiction.

Once a non-EU CCP is recognized by ESMA, it will also be able to obtain status as a qualifying CCP under the EU Capital Requirements Regulation, which will allow non-US clearing members that are part of an EU corporate group to benefit from favorable capital treatment. Additionally, any over-the-counter derivatives subject to a mandatory clearing determination under EMIR can be cleared on an ESMA-recognized non-EU CCP.

The EC is continuing to consider whether to make equivalency determinations for additional jurisdictions, including the United States.

A link to the EC press release can be found here. Links to the each equivalency determination can be found at: Australia, Hong Kong, Japan, and Singapore.

Italian Short-Term Ban on Shorting Banca Monte dei Paschi di Siena spa and Banca Carige spa

On October 27, the Commissione Nazionale per le Società e la Borsa (CONSOB), the Italian securities regulator, issued an emergency short selling measure under the European Union's Short Selling Regulation (Regulation 236/2012). The emergency measure consists of a ban on the creation of new net short positions and a ban on the increase of existing net short positions on shares issued by Banca Monte dei Paschi di Siena spa and Banca Carige spa.

The ban was introduced following the announcement on October 26 of significant regulatory capital shortfalls for both Banca Monte dei Paschi and Banca Carige in the results of the European Central Bank's (ECB) comprehensive assessment.

Under the Short Selling Regulation, within 24 hours of notification of a short selling measure by any EU regulator, the European Securities and Markets Authority (ESMA) must issue an opinion on whether it considers the measure necessary to address exceptional circumstances facing the issuer(s) in question. ESMA has confirmed that it is of the view that the measure notified by the CONSOB is appropriate and proportionate to minimize the risk of a loss of market confidence on these shares, reduce the risk of a contagion effect to other shares of the Italian banking sector, address adverse developments in the Italian markets, and that the duration of the measure is justified.

The measure entered into force on October 27 following the publication of ESMA's opinion, and is expected to be applicable until the end of the day on November 10.

For the CONSOB measure, please click here.

For ESMA's opinion, please click here.

For the ECB's assessment of EU banks, please click here.

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