Katten
Katten Muchin Rosenman LLP

CORPORATE & FINANCIAL
WEEKLY DIGEST

January 30, 2015 Volume X Issue 4

SEC/CORPORATE

SEC Division of Corporation Finance Issues New C&DI Related to Resales Under Regulation S

On January 23, the Securities and Exchange Commission's Division of Corporation Finance issued a new Compliance and Disclosure Interpretation (C&DI) regarding the resale of securities under Regulation S of the Securities Act of 1933 (Securities Act), which provides an exclusion from the Securities Act's registration requirements for offerings made outside of the United States of securities of US and foreign issuers. Specifically, C&DI 279.01 clarifies that the resale limitations under Rule 905 of Regulation S only apply to equity securities of issuers that were "domestic issuers" (as such term is defined under Rule 902 of Regulation S) at the time of the issuance of such securities. Accordingly, a holder of restricted securities that were acquired from a foreign private issuer that, following such acquisition, no longer qualifies as such, may resell such securities offshore pursuant to Rule 904 of Regulation S without regard to Rule 905.

The full text of C&DI 279.01 can be found here.

SEC Announces Proxy Voting Roundtable

The Securities and Exchange Commission has announced that it will host a roundtable on February 19 on ways to improve the proxy voting process, with a focus on universal proxy ballots and retail (non-institutional) shareholder participation in the proxy process. The roundtable will consist of the following two panels:

- The first panel will examine (1) contested director elections and whether the proxy rules should be changed to facilitate the use of universal proxy ballots, and (2) state law, logistical and disclosure issues presented by a universal proxy ballot process. A universal proxy ballot would allow management and proxy contestants to list all director nominees, including opposing candidates, on a single ballot in a proxy contest, which proponents argue would provide shareholders with more freedom in electing directors.
- The second panel will focus on (1) strategies for increasing retail shareholder participation in the proxy process, (2) how technology could be better implemented to increase retail participation, and (3) whether the format of proxy statement disclosures and the mechanics of voting could be improved to increase shareholder engagement.

The roundtable, which will be held at the SEC's Washington, DC headquarters, will be open to the public and webcast live on the SEC's website.

The SEC's press release can be read here.

CFTC

CFTC Staff Issues No-Action Relief From Certain Financial Reporting Requirements Applicable to Introducing Brokers

On January 23, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediary Oversight (DSIO) issued a no-action letter regarding financial reporting requirements as they apply to foreign introducing brokers (IBs). The no-action relief allows foreign domiciled IBs and IB applicants to (1) prepare and file Form 1-FR using accounting principles of the IB's jurisdiction in lieu of US Generally Accepted Accounting Principles or International Financial Reporting Standards, and (2) report account balances on Form 1-FR-IB in the local currency of the IB's jurisdiction without applying the foreign currency capital charges that would otherwise be required by CFTC Regulation 1.17 (and related CFTC staff guidance) when calculating adjusted net capital.

This relief is subject to the following conditions: (1) Form 1-FR-IB and all certified financial reports must be prepared in English; (2) Form 1-FR-IB must include a Statement of the Computation of the Minimum Capital Requirements prepared in accordance with CFTC Regulation 1.17 and a second Statement of the Computation of the Minimum Capital Requirements with balances converted to US dollars as of the reporting date to demonstrate that the IB is in compliance with the CFTC's capital requirements; and (3) each IB must comply with the foreign currency capital charges set forth in CFTC Regulation 1.17 and CFTC staff guidance, but may exclude capital charges for deposits of the IB's local currency in the IB's jurisdiction or in money center countries.

The no-action letter also states that DSIO will not recommend enforcement action against an IB that, in computing its adjusted net capital under CFTC Regulation 1.17, recognizes as a current asset a commissions receivable balance from an over-the-counter swap customer that has been billed during the calendar month of the receivable balance's origination and that has not aged more than 30 days from when it was billed.

The no-action letter is available here.

CME Group Exchanges Revise Position Limit Rules

The Chicago Mercantile Exchange, Chicago Board of Trade, New York Mercantile Exchange and Commodity Exchange have revised their position limit rules by removing provisions that formerly deemed a market participant to have violated a position limit if it entered a bid or offer that, if accepted, would cause the market participant to exceed the position limit. The revised position limit rules also clarify that the position limits established by the exchanges are applied on an intraday basis. The exchanges further noted that all bids and offers remain subject to the exchanges' disruptive trading practices rules. The revised rules are effective February 6, pending relevant regulatory review periods.

The Special Executive Report describing the revised rules is available here.

NFA Announces New Filing Process for Swap Dealer and Major Swap Participant CCO Reports

On January 23, the National Futures Association (NFA) issued a notice informing its members that the annual reports required by NFA rules to be submitted by the chief compliance officer (CCO) of a swap dealer (SD) or major swap participant (MSP) must be filed with NFA through the WinJammer system and no longer need to additionally be filed through the CFTC's web-based portal. A January 23 CFTC press release makes clear that, while an SD or MSP may file the CCO annual report through the CFTC portal, the CFTC will automatically receive reports that have been filed through WinJammer and that such a filing satisfies the requirement to file the report with the CFTC. This change in the filing process is effective for CCO annual reports for any fiscal year ending on or after October 31, 2014. In order to file the annual report through WinJammer, swap dealers and major swap participants must create a "Regulation Notice – Swaps" in the filing index of WinJammer as of the ending date of the report, select the "Chief Compliance Officer Annual Report – Swaps" filing type and upload the report as a .pdf file.

NFA's notice to members is available here.

The CFTC press release is available here.

NFA Increases Minimum Security Deposits for Forex Transactions

The Executive Committee of the National Futures Association (NFA) has temporarily increased the minimum security deposits required to be collected and maintained by forex dealer members (FDMs) for foreign exchange transactions involving the Japanese yen, Australian dollar, Russian ruble, Brazilian real and Mexican peso. Effective until further notice, FDMs must collect and maintain a minimum security deposit of three percent of the notional value of transactions in the Japanese yen and Australian dollar, twenty percent of the notional value of transactions in the Russian ruble, nine percent of the notional value of transactions in the Brazilian real and six percent of the notional value of transactions in the Mexican peso.

NFA's notice to members is available here.

LITIGATION

Bharara Appeals Second Circuit's Decision Vacating Insider Trading Convictions

Preet Bharara, United States Attorney for the Southern District of New York, has petitioned the United States Court of Appeals for the Second Circuit for a rehearing *en banc* of last month's landmark decision vacating multiple insider trading convictions, arguing that the decision creates a new "deeply confounding" standard that splits from precedent in this and other circuits, and threatens the effective enforcement of the securities laws.

As covered previously here, in *United States v. Newman* the Second Circuit held that to convict a tippee for insider trading under Section 10(b) of the Securities Act of 1934 the Government must prove beyond a reasonable doubt that the tippee had knowledge of the benefit received by the tipper, and not mere knowledge that the tipper had breached his or her duty of confidentiality. Finding that the Government had not proven that hedge fund managers Todd Newman and Anthony Chiasson—who had received tips from financial analysts, who themselves had allegedly received tips from insiders at Dell and NVIDIA—knew of the original tippers' personal benefit from providing such information, the Second Circuit overturned their convictions for insider trading.

The Government has challenged this heightened standard as contrary to *Dirks v. SEC*, 463 U.S. 646 (1983) and other precedent. In particular, the Government contends that the Second Circuit "effectively nullified part of the *Dirks* benefit test" by "eliminating *Dirks*'s express recognition that an improper but uncompensated gift of information by an insider suffices." The Government also claims that the new standard, which considers, among other things, a "meaningfully close personal relationship," lacks any "familiar meaning in this or any analogous area of law."

In its petition, the Government contends that *Newman* will severely hamper its ability to prosecute "some of the most common, culpable, and market-threatening forms of insider trading." The Government warns that the "ambiguous and diluted notion" of a tipper's personal benefit will allow hedge fund managers and other traders to "insulate themselves from tippee liability by knowingly placing themselves at the end of a chain of inside information" and turning a blind eye to the sources of inside information.

The SEC, which filed an *amicus* brief, has largely seconded the Government's arguments.

United States v. Newman et al., Cases No. 13-1837(L), 1301917(CON) (2d Cir. 2015).

Study Finds Executive Compensation Clawback Provisions Do Not Eliminate Possible Earnings Manipulation

Academics in Hong Kong have found that companies that have adopted executive compensation clawback provisions tend to substitute one type of earnings manipulation for another, and that this trend is more pronounced in companies with high growth or transient institutional ownership.

In an article published in the American Accounting Association's journal, the authors analyzed companies from the Russell 3000 that voluntarily adopted clawback provisions of the type required by Section 954 of the Dodd-Frank Act. Because the Securities and Exchange Commission has not yet finalized the rules to implement this section, only some companies have adopted these measures. Section 954 is intended to deter financial misstatements.

By carefully matching about 250 companies that have adopted clawback provisions with those that have not, the authors investigated two main questions: (1) do clawbacks lead companies to substitute one type of earnings manipulation with another; and (2) which kind of company is more likely to engage in these substitutions: companies with high-growth opportunities or companies with high-transient institutional ownership?

The authors found that clawbacks reduce accruals management, or the manipulation of balance-sheet items that require some estimation, like bad debt reserves. However, clawbacks increase real transactions management, or the alteration of actual expenditures to increase temporary earnings, such as by reducing R&D costs. Thus, one type of manipulation is merely replaced with another that, according to the authors, is less likely to attract scrutiny from auditors or regulators.

This trend was more pronounced in high-growth companies, which are more likely to suffer a sharp drop in price if they miss forecasts, and in companies with high-transient institutional ownership, which focus on short-term earnings.

Ultimately, the authors conclude that clawbacks do not fully eliminate earnings manipulation. In addition, the increased reliance on real transactions management causes companies to sacrifice long-term value for a boost in short-term profits.

[eds. Lilian H. Chan, et al., "Substitution Between Real and Accruals-Based Earnings Management After Voluntary Adoption of Compensation Clawback Provisions," *The Accounting Review* Vol. 90, No. 1 (Jan. 2015).]

UK DEVELOPMENTS

Retail Investment Advice: Clarifying the Boundaries and Exploring the Barriers to Market Development

On January 22, the UK Financial Services Authority (FCA) published *Finalised Guidance - 15/1: Retail investment advice: Clarifying the boundaries and exploring the barriers to market development* (the Guidance). The Guidance followed consideration by the FCA of responses to Consultation 14/3 (which had closed in October 2014) by which the FCA had sought the views of market participants as to how firms should interpret the boundaries of investment advice.

The main purpose of the Guidance is to clarify what constitutes a personal recommendation (for the purpose of the Markets in Financial Instruments Directive II (MiFID) definition of investment advice) in relation to investments based on different retail investment sales models. It also provides guidance on the meaning of "investment advice" with respect to the retail sector by consolidating existing guidance that is available from the FCA, the Committee of European Securities Regulators (CESR) and the European Securities and Markets Authority (ESMA). In the Guidance, the FCA provides detailed example scenarios, offering in each case a view on whether the FCA thinks it includes the provision of investment advice (and hence constitutes a regulated activity within the ambit of the FCA) or not, and explores specific issues in this area that stakeholders have raised with the FCA.

The Guidance can be found here.

See also "AIFM Directive Annex IV Reporting Delayed/Postponed in the Netherlands and the United Kingdom under EU Developments."

EU DEVELOPMENTS

AIFM Directive Annex IV Reporting Delayed/Postponed in the Netherlands and the United Kingdom

On January 28, the Dutch regulator (Authority for Financial Markets (AFM)) announced that the Alternative Investment Fund Managers (AIFM) Directive's Annex IV reporting obligation has been postponed for non-EU managers until further notice.

As is the case in each of the countries of the European Union, for a manager of an alternative investment fund (the manager being an "AIFM" and the fund being an "AIF" under the AIFM Directive) to be able to conduct marketing in the Netherlands and to be able to use the Dutch private placement rules it is necessary first to file

with the local regulator. Once that registration is in place, the follow-up obligations include filing a semi-annual or quarterly risk report, known in the AIFM Directive as Annex IV. The first Annex IV filing is due on January 31in each EU country where the AIFM has filed for marketing.

The Dutch Central Bank (DNB) and the AFM have announced that the DNB will send a letter to all registered non-EU AIFMs in due course informing them as to the updated requirements for their Annex IV fund reporting in the Netherlands and when such reporting will now be due. Given that the Annex IV report is an EU legal requirement for AIFMs, the AFM has clarified that no enforcement action will be taken against non-EU AIFMs for failing to report as of January 31.

The AFM's announcement has since been followed on January 29by an email sent to many registered AIFMs from the UK Financial Conduct Authority (FCA) that the FCA has been experiencing ongoing systems issues with its electronic filing system, known as GABRIEL (GAthering Better Regulatory Information Electronically), which it is currently working to resolve. As a result, many AIFMs (whether EU or non-EU) have been having difficulty accessing GABRIEL or, if they have been able to log in, to complete their data-entry sessions once within the system. As with the situation in the Netherlands, the FCA has announced that it will not take any enforcement action against firms affected by these issues for a failure to report for the relevant AIF by January 31. However, this is provided that the AIFM submits its reports to the FCA for the AIF as soon as possible after the issues with the system have been resolved.

Any non-EU AIFMs that *do* have filing details from the Dutch DNB or from the UK FCA and who can access the system should file before the January 31 deadline or otherwise in accordance with the relevant regulator's instructions.

The Dutch AFM's announcement (third item on the page) is available here.

Fourth EU Money Laundering Directive Endorsed by European Parliament

The Fourth Money Laundering Directive (4MLD) of the European Union has been endorsed by two key European Parliament committees, which now means that EU countries must implement the changes within two years (i.e., it is anticipated to come into effect in early 2017).

The European Parliament and the EU Council of Ministers struck a deal in December 2014 and this was endorsed by both the Economic and Monetary Affairs and Civil Liberties committees of the European Parliament in Brussels by a significant majority vote of 87 "for" and two "against." The 4MLD will replace the European Union's Third Money Laundering Directive and will:

- introduce a risk-based approach;
- extend the rules for politically exposed persons (PEPs) so that domestic PEPs will be treated in the same way as foreign PEPs, meaning that they will be considered high risk from a due diligence perspective and additional measures will have to be followed to establish the source of their wealth and funds, for example; and
- oblige EU countries to maintain centralized registers detailing beneficial ownership information for companies established within the European Union, with such registers being accessible to regulators, financial intelligence units, banks and persons who have a "legitimate interest" in suspected money laundering (it is not yet clear who such persons might include).

The final full European Parliament vote will be held in March or April 2015 and is now anticipated to be a mere formality.

For the most up-to-date draft of the 4MLD text click here.

For more information, contact:

SEC/CORPORATE

David S. Kravitz	+1.212.940.6354	david.kravitz@kattenlaw.com
Mark J. Reyes	+1.312.902.5612	mark.reyes@kattenlaw.com
Austin G. Leach	+1.212.940.6552	austin.leach@kattenlaw.com
Mark D. Wood	+1.312.902.5493	mark.wood@kattenlaw.com

FINANCIAL SERVICES

Janet M. Angstadt	+1.312.902.5494	janet.angstadt@kattenlaw.com
Henry Bregstein	+1.212.940.6615	henry.bregstein@kattenlaw.com
Kimberly L. Broder	+1.212.940.6342	kimberly.broder@kattenlaw.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@kattenlaw.com
Guy C. Dempsey Jr.	+1.212.940.8593	guy.dempsey@kattenlaw.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@kattenlaw.com
Jack P. Governale	+1.212.940.8525	jack.governale@kattenlaw.com
Arthur W. Hahn	+1.312.902.5241	arthur.hahn@kattenlaw.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@kattenlaw.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@kattenlaw.co.uk
Kathleen H. Moriarty	+1.212.940.6304	kathleen.moriarty@kattenlaw.com
Ross Pazzol	+1.312.902.5554	ross.pazzol@kattenlaw.com
Kenneth M. Rosenzweig	+1.312.902.5381	kenneth.rosenzweig@kattenlaw.com
Fred M. Santo	+1.212.940.8720	fred.santo@kattenlaw.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@kattenlaw.com
Peter J. Shea	+1.212.940.6447	peter.shea@kattenlaw.com
James Van De Graaff	+1.312.902.5227	james.vandegraaff@kattenlaw.com
Robert Weiss	+1.212.940.8584	robert.weiss@kattenlaw.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@kattenlaw.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@kattenlaw.com

LITIGATION

Michael M. Rosensaft	+1.212.940.6631	michael.rosensaft@kattenlaw.com
Tenley Mochizuki	+1.212.940.8568	tenley.mochizuki@kattenlaw.com

UK/EU DEVELOPMENTS

David A. Brennand	+44.20.7776.7643	david.brennand@kattenlaw.co.uk
Neil Robson	+44.20.7776.7666	neil.robson@kattenlaw.co.uk

* Click here to access the *Corporate and Financial Weekly Digest* archive.

Attorney advertising. Published as a source of information only. The material contained herein is not to be construed as legal advice or opinion.

©2015 Katten Muchin Rosenman LLP. All rights reserved.

Katten

Katten Muchin Rosenman LLP www.kattenlaw.com

AUSTIN | CENTURY CITY | CHARLOTTE | CHICAGO | HOUSTON | IRVING | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SAN FRANCISCO BAY AREA | SHANGHAI | WASHINGTON, DC

Katten Muchin Rosenman LLP is an Illinois limited liability partnership including professional corporations that has elected to be governed by the Illinois Uniform Partnership Act (1997).

London: Katten Muchin Rosenman UK LLP.