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Corporate & Financial Weekly Digest

April 14, 2017 Volume XII, Issue 14

SEC/CORPORATE

SEC Division of Corporation Finance Provides Update on Conflict Minerals Rule

On April 7, the Securities and Exchange Commission Division of Corporation Finance (the Division) issued a statement regarding the effect of recent judicial action with respect to the SEC's conflict minerals rule. In its statement, the Division clarified that, in light of the uncertainty regarding the rule, subject to further review, the Division will not pursue enforcement actions against companies that do not comply with the "source and chain of custody" due diligence requirements and related disclosure in Item 1.01(c) of Form SD.

As discussed in the August 21, 2015, edition of *Corporate & Financial Weekly Digest*, the US Court of Appeals for the District of Columbia Circuit held that the conflict minerals rule violates the First Amendment to the extent it requires companies to report to the SEC and disclose on their website that their products have not been found to be "DRC conflict free." On April 3, the US District Court of the District of Columbia entered a final judgment in accordance with the Court of Appeals' decision and remanded the rule to the SEC for further action. Acting SEC Chair Michael Pinowar noted that the due diligence requirements, which will not be enforced, were adopted to enable companies to make disclosures that have now been found to be unconstitutional. He also explained that he has instructed the SEC staff to commence work on a recommendation for future SEC action.

While companies are still required to comply with the remaining disclosure requirements under Form SD, the "source and chain of custody" requirements are widely regarded as the most onerous aspects of the rule. The courts' actions, the Division's statement and the remarks by acting Chairman Piwowar raise questions as to the future of the conflict minerals rule.

The complete text of the updated statement from the Division is available here. The complete text of Chair Pinowar's statement is available here.

SEC Division of Corporate Finance Issues New C&DIs on "Regulation A+" and Regulation Crowdfunding

The Securities and Exchange Commission's Division of Corporation Finance recently issued new compliance and disclosure interpretations (C&DIs) related to so-called "Regulation A+" and Regulation Crowdfunding promulgated under the Jumpstart Our Business Startups (JOBS) Act. The C&DIs pertaining to Regulation Crowdfunding were issued on the same day as the SEC's announcement of the adoption of technical amendments to the JOBS Act Rules, including amendments to increase the amount of money companies can raise through crowdfunding (as discussed in the April 7 edition of *Corporate & Financial Weekly Digest*).

The new C&DIs address the following issues (among others):

Regulation A+

> C&DI 182.16 provides that the SEC will not object to an issuer filing a Form 1-Z to suspend its Tier 2 reporting obligation after the issuer (that was not previously subject to a Tier 2 Regulation A reporting obligation) qualifies an offering statement pursuant to Tier 2 and withdraws its offering statement pursuant to Rule 259 before making any sales in that offering, even though the withdrawal occurs before the issuer has

filed an annual report for the fiscal year in which the offering statement was qualified. The full text of this C&DI is available here.

In C&DI 182.17, the SEC explains that, while pursuant to paragraph (c)(1)(i) of Part F/S of Form 1-A (Regulation A offering statement), Tier 2 offerings may follow paragraphs (b)(3)-(4) of Part F/S for the age of interim financial statements, an issuer in a Tier 2 offering may also follow those paragraphs for full fiscal years. The full text of this C&DI is available here.

In C&DI 182.18, the SEC clarifies that an issuer qualifying an offering pursuant to Regulation A is not required to file a tax opinion as an exhibit to its Form 1-A, but the issuer may elect to do so as an additional exhibit pursuant to paragraph 15(b) of Item 17 of Part III of Form 1-A. The full text of this C&DI is available here.

In C&DI 182.19, the SEC indicates it would not object to an issuer with ongoing Regulation A reporting obligations not including as an exhibit to its Form 1-K an auditor's consent to the use of an audit report for the financial statements in the issuer's Form 1-K. The full text of this C&DI is available here.

Regulation Crowdfunding

C&DI 201.02 explains that, for purposes of Rule 201(r) (which requires that an issuer disclose any related party transaction that exceeds 5 percent of the amount raised by an issuer during the prior 12-month period in reliance on the exemption from registration provided under section 4(a)(6) of the Securities Act of 1933), the threshold for disclosure of related party transactions should be based upon the target offering amount plus any amount already raised in reliance on 4(a)(6) during the prior 12-month period. This means that, even if an issuer would be willing to accept proceeds in excess of the target offering amount for the current offering, the issuer should not include the potential proceeds in excess of the target in making the 5 percent calculation unless those amounts have already been raised. The full text of this C&DI is available here.

C&DI 202.01 clarifies that, for purposes of calculating the number of holders of record for determining whether an issuer may terminate its obligation to file reports pursuant to Rule 202(b)(2) of Regulation Crowdfunding, an issuer should count all holders of record of securities of the same class as the securities issued in the Regulation Crowdfunding offering for which the issuer has a reporting obligation. Thisincludes, for purposes of clarity, holders of record that purchased such securities other than in the Regulation Crowdfunding offering. The full text of this C&DI is available here.

BROKER-DEALER

National Adjudicatory Council Revises Sanction Guidelines

The Financial Industry Regulatory Authority, through the National Adjudicatory Council (NAC), has revised the FINRA Sanction Guidelines that hearing panels and the NAC use in determining appropriate remedial sanctions for FINRA members in disciplinary proceedings. Among other changes, the revised Sanction Guidelines include the following additions:

- three new guidelines: Supervision—Systemic Supervisory Failures, Borrowing From or Lending to Customers and Short Interest Reporting;
- a new general principle examining the mitigating effects of regulatory or firm-imposed sanctions and corrective action;
- a new factor considering whether a respondent has exercised undue influence over a customer;
- revised sanctions for more serious FINRA rule violations; and
- other conforming changes.

The new guidelines were effective immediately upon publication. More details are available in FINRA Regulatory Notice 17-13.

DERIVATIVES

See "CFTC Releases No-Action Letter Regarding the Transfer of Customer-Owned Securities by FCMs to Foreign Brokers" in CFTC section.

CFTC

NFA Issues Notice Regarding Updated FinCEN AML/CFTC Guidance

On April 10, the National Futures Association (NFA) published Notice I-17-09, which notified member futures commission merchants (FCMs) and introducing brokers (IBs) of an April 5 advisory published by the Financial Crimes Enforcement Network (FinCEN), regarding updates to the Financial Action Task Force's list of jurisdictions with strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies. The advisory includes specific updates regarding AML/CFT compliance issues related to the Democratic People's Republic of Korea, Iran and Ethiopia. NFA reminded member FCMs and IBs to review the aforementioned advisory and revise, if necessary, their respective AML programs to comply with the new guidance.

Notice I-17-09 is available here.

The FinCEN advisory is available here.

CFTC Releases No-Action Letter Regarding the Transfer of Customer-Owned Securities by FCMs to Foreign Brokers

On April 11, the Commodity Futures Trading Commission's Division of Swap Dealer and Intermediate Oversight (DSIO) made publicly available No-Action Letter No. 16-88. This letter grants no-action relief to a futures commission merchant (FCM) intending to deposit customer-owned securities in an individual client account (ISA) with a United Kingdom affiliate (Affiliate) for purposes of margining such customers' foreign futures or foreign options positions executed on a foreign board of trade located in the UK and cleared through a clearing organization that (1) is a central counterparty (CCP) that has received a recognition order as a recognized clearing house (RCH) and is subject to supervision by the Bank of England under Part 18 of the Financial Services and Markets Act 2000; and (2) has been authorized as a CCP pursuant to Article 17 of Regulation (EU) No 648/2012 of the European Parliament and the July 4, 2012 Council on OTC derivatives, central counterparties and trade repositories (an EU CCP).

EU CCP rules generally require a clearing member to have (1) sole and legal beneficial ownership in any securities posted with the EU CCP as margin; or (2) have the customer's consent to treat such securities as if it had such ownership. Such rules are inconsistent with CFTC Regulation 30.7, which provides that an FCM may not by contract or otherwise waive any of the protections afforded customer funds under the laws of the foreign jurisdiction. Therefore, Regulation 30.7 would not permit an FCM to (1) transfer legal and beneficial ownership of customer-owned securities; or (2) grant an affiliate the right to reuse such securities (which would constitute a transfer of legal title of the securities at the time such right of reuse is exercised).

In response to these regulatory inconsistencies, the FCM, seeking no-action relief, proposed a series of amendments to its Futures Agreement. Such amendments included, but were not limited to, requirements that (1) the FCM authorize all transfers out of an ISA at an EU CCP; and (2) the Affiliate transfer securities directly from the FCM's custody account to the ISA at the EU CCP promptly upon receipt of such securities. In addition, the proposed Futures Agreement would restrict the Affiliate's right to reuse customer funds to ensure such transfers complied with the UK's Financial Conduct Authority's Custody Rules. The FCM further agreed to obtain a customer's consent before transferring customer-owned securities to its Affiliate for this purpose.

Based on the foregoing, DSIO granted no-action relief, noting that customer-owned securities transferred to an ISA under such an arrangement would be consistent with CFTC rules. Such no-action relief is conditioned upon the FCM's continued compliance with a series of conditions including, but not limited to, the FCM and the Affiliate not lending, appropriating, disposing of or otherwise using customer-owned securities for their own purposes when exercising their right to reuse.

The CFTC's no-action letter is available here.

NFA Announces Cybersecurity Member Regulatory Workshop Sessions

On April 12, the National Futures Association (NFA) announced two upcoming Member Regulatory Workshop sessions that will discuss members' regulatory responsibilities regarding cybersecurity. NFA staff will provide updates on their cybersecurity examination findings, and a panel of experts will share best practices. The sessions will be held in New York on May 10 and in Chicago on May 11.

More information regarding the sessions is available here.

BREXIT/UK DEVELOPMENTS

New Private Fund Limited Partnership Structure Now Available

On April 6, the Legislative Reform (Private Fund Limited Partnerships) Order 2017 (LRO), implementing changes to the Limited Partnerships Act 1907, introduced a new subcategory of limited partnership known as the private fund limited partnership (PFLP).

As previously reported in the *Corporate & Financial Weekly Digest* editions of February 24, 2017, and August 7, 2015, the introduction of the PFLP has been designed to reduce the administrative and financial burdens that impact funds established in the United Kingdom under the current limited partnership (LP) structure, thereby seeking to make the United Kingdom a more attractive jurisdiction for funds.

The LRO has not been substantively amended since the draft form was released in January, meaning that the key provisions relating to the non-exhaustive "white-list" of activities a limited partner is permitted to undertake without being deemed to be involved in the management of the LP—more relaxed rules on winding up; the removal of requirements to register certain changes to a PFLP, which would otherwise apply to an LP; and the removal of any prohibition on the withdrawal of capital contributions from PFLPs—remain intact.

New and existing English LPs that qualify as collective investment schemes, as defined in the Financial Services and Markets Act 2000, will be able to elect to become PFLPs using the new forms LP7 and LP8 contained in the LRO. Partnership agreements of existing English LPs are likely to require some consequent amendments to be made to correspond with the registration of the relevant partnership as a PFLP.

The text of the LRO is available here.

PRA Issues "Dear CEO" Letters on Brexit Contingency Planning

On April 7, the Prudential Regulation Authority (PRA) published a copy of the "Dear CEO" letter it had sent to firms relating to contingency planning for the UK's withdrawal from the European Union. The letter was sent by Sam Woods, chief executive officer of the PRA, in response to a speech by Mark Carney, governor of the Bank of England—also delivered on April 7—on the future of global financial services regulation (available here).

The letter is relevant to banks, insurers and designated investment firms undertaking cross-border activities between the United Kingdom and the rest of the European Union. The PRA explains in the letter that it expects all such firms to undertake appropriate contingency planning for the UK's withdrawal from the European Union. It notes that while the government is aiming for a comprehensive new trade relationship with the European Union, coupled with an implementation period, a wide range of outcomes are possible at this early stage. The PRA expects firms to plan for a variety of potential scenarios, so that the safety and soundness of their UK operation is assured, and the risk of any adverse financial stability impacts on the UK economy is mitigated. The Financial Policy Committee of the Bank of England will oversee the plans to mitigate risks to financial stability.

The PRA advises that the current level of planning is uneven across firms, and plans may not be being sufficiently tested against the most adverse potential outcomes (for example, if there is no trade agreement in place when the United Kingdom exits from the European Union). Where firms currently rely on passporting, the PRA expects them to have full contingency plans that cover a range of potential scenarios, including the most adverse potential outcomes. In particular, firms currently relying on passporting to carry on business in the United Kingdom should take into account the need to apply to the PRA for authorization, which may be required to enable them to continue operating either as an incoming branch or as a subsidiary after the UK's withdrawal from the European Union.

In response to the letter, the PRA asks firms for written confirmation from their board or local branch senior management that they have considered their firm's contingency plans, a short summary of the plans and assurance that the plans appropriately address a wide range of scenarios. Where authorization or other regulatory engagement is required, the PRA asks to be informed of those plans. For firms that have a small European element to their business, a *de minimis* response will likely be sufficient.

The PRA will use responses as input to its own contingency planning, and will share relevant information with the Financial Conduct Authority.

Full responses to the letter are expected by July 14, 2017.

The letter is available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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UK DEVELOPMENTS

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