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CORPORATE & FINANCIAL
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DERIVATIVES

International Regulators Publish "Near-Final" Draft of Uncleared Swap Margin Rules

On February 15, the Bank for International Settlements (BIS) and the International Organization of Securities Commissions (IOSCO) published the Second Consultative Document on margin requirements for non-centrally cleared derivatives.

The document sets out the "near-final" international policy framework for margining derivative transactions that are not cleared through a central counterparty (CCP). The framework is needed in order to coordinate the individual responses of the G20 nations to their commitment to introduce mandatory initial and variation margin rules as part of their program to reduce systemic risk from uncleared over-the-counter derivatives. Although the US swap regulators have previously proposed their own margin requirements for derivatives under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, it is expected that those proposals will be modified to be substantially consistent with the final international policy framework.

The key elements of the BIS-IOSCO approach can be summarized as follows:

1. Initial and variation margin should apply to all derivative transactions that are not cleared by CCPs except for physically settled foreign exchange (FX) forwards and swaps.

2. Margin rules should apply only to financial firms and systemically important non-financial entities (Covered Entities), but not other entities.

3. Covered Entities can agree on a threshold of up to €50 million for exchange of initial margin. The threshold for variation margin is zero.

4. A Covered Entity is exempt from initial margin requirements if the gross outstanding notional amount of its swap portfolio (measured on a rolling basis) is less than €8 billion.

5. Initial margin may be calculated by reference to (a) a margin model approved by relevant regulators, or (b) a standard schedule that, for example, requires initial margin equal to 1% of notional for an interest rate swap with a duration of less than two years and 4% of notional for a swap with a duration of more than five years. Initial margin can be adjusted by an amount that relates to the net-to-gross ratio pertaining to derivatives subject to a legally enforceable netting arrangement.

6. Initial margin must be exchanged by covered entities on a gross, two-way basis and must be held in a manner that protects the posting party from the insolvency of the collecting party.

7. Exemptions for swaps with affiliates are left to national regulation.

8. Covered entities in different countries with comparable margin rules can agree which set of rules will apply.

9. The rules for variation margin will not come into effect until January 1, 2015. The rules for initial margin will be phased in starting in 2015 based on the notional amount of swaps executed in the last three months of 2014. Full implementation may not occur before 2019.

10. All swaps executed prior to 2015 will be grandfathered.

Comments must be submitted by March 15, 2013, and have been specifically requested with respect to the following four issues:

- the treatment of physically settled FX forwards and swaps under the framework;
- the ability to engage in limited re-hypothecation of collected initial margin;
- the proposed phase-in framework; and
- the adequacy of the related quantitative impact study.

The full text of the Second Consultative Document can be found here.

CFTC

CFTC and IOSCO to Host Roundtable on IOSCO Financial Benchmarks Report

Staff of the Commodity Futures Trading Commission, in conjunction with the International Organization of Securities Commissioners (IOSCO), will host a public roundtable to discuss IOSCO's recently published Consultation Report on "Financial Benchmarks." The roundtable is intended to address, among other things, concerns of benchmark users, including methodology and transparency and governmental oversight of benchmark activities.

The roundtable will be held at the CFTC's headquarters in Washington, D.C. on February 26 and will be open to the public. Members of the public may also listen by telephone.

More information on the roundtable can be found here.

The IOSCO Consultation Report can be found here.

LITIGATION

SDNY Favors the SEC in Foreign Corrupt Practices Act Action Involving Novel Issues of Statutory Interpretation

In a case addressing an issue of first impression involving the Foreign Corrupt Practices Act (FCPA), the US District Court for the Southern District of New York adopted an expansive interpretation of the statute's interstate commerce requirement to allow the imposition of liability on foreign nationals for bribery occurring in a foreign country with only unintentional conduct in the United States. The Securities and Exchange Commission also benefited from a second ruling tolling the statute of limitations until the defendants were physically present in the United States.

This enforcement action was brought by the SEC in December 2011 against executives of a Hungarian telecommunications company (together, Defendants), alleging that in 2005 they bribed Macedonian government officials in order to gain beneficial treatment for Defendants' company, which was SEC-registered and traded American depositary receipts on a US exchange during the relevant period. The SEC alleged that Defendants concealed their scheme and executed falsified certifications to the auditors and made false sub-representations for quarterly reports filed with the SEC.

The District Court rejected the argument that the SEC failed to allege Defendants' "use of United States interstate commerce" in furtherance of the bribery scheme, as required by the FCPA. The only conduct alleged to reach the United States was the email transmittal of "sham" contracts used to conceal the bribes. The emails were sent between individuals outside the United States, but were allegedly routed or stored on network servers in the United States. Defendants argued that such conduct was insufficient because they did not purposely intend their emails to be routed through the United States. Conceding that the statute was ambiguous, the District Court nevertheless held, based on legislative history and interpretations of criminal statutes with similar provisions, that the FCPA does not require a showing of intent to use the means of instrumentalities, only that those instrumentalities had in fact been used.

In addition, the District Court found that the SEC's claims were timely under the applicable five (5)-year statute of limitations contained in 28 U.S.C. § 2462. While it was undisputed that the SEC filed its complaint more than five years <u>after</u> both the alleged misconduct and the company's disclosure to the SEC of an internal investigation into that conduct, the District Court agreed that, under the plain language of the limitations statute, "an offender must be physically present in the United States for the statute of limitations to run." Despite the availability to the SEC of worldwide service of process, the District Court held that the SEC had no obligation to serve the Defendants outside of the United States as the limitations period was not running when Defendants were not within the United States.

SEC v. Straub, et al., No. 11 Civ. 9645 (RJS) (S.D.N.Y. February 8, 2013).

SDNY Finds Lack of Personal Jurisdiction in Foreign Corrupt Practices Act Claim

The US District Court for the Southern District of New York recently addressed whether the Foreign Corrupt Practices Act (FCPA) could reach a foreign executive of a non-US company. In contrast to the *Straub* case (see "SDNY Favors the SEC in Foreign Corrupt Practices Act Action Involving Novel Issues of Statutory Interpretation" in **Litigation** above), the District Court declined to exercise personal jurisdiction over the moving defendant. The decision offers a potential limiting principle for the reach of personal jurisdiction under the FCPA.

Following the resolution of criminal and civil FCPA claims against Siemens Aktiengesellschaft (Siemens) and proceedings in Germany, the Securities and Exchange Commission brought this enforcement action against, among others, Herbert Steffen (Steffen), a former Siemens executive. The complaint alleged that the defendant executives participated in a scheme during the period 1996 to 2007 to bribe Argentinian government officials to gain beneficial treatment for Siemens. The SEC further alleged that the executives made false certifications pursuant to the Sarbanes-Oxley Act regarding the accuracy of Siemens' quarterly and annual certifications to the SEC. Steffen's alleged role in the scheme was limited to encouraging another Siemens executive to authorize the bribes to Argentinian officials. There were no allegations that Steffen had authorized the bribes himself, participated in the cover-up or had any involvement in the alleged falsification of SEC filings.

Steffen moved to dismiss and the District Court agreed that the SEC failed to allege the facts necessary to assert jurisdiction over him in the United States. Citing to *Straub*, the District Court explained that in FCPA cases, minimum contacts with the United States necessary to establish personal jurisdiction exist where "an executive of a foreign securities issuer, wherever located, participates in a fraud *directed* to deceiving United States shareholders" (emphasis in original). Here, however, the District Court found that Steffen's alleged conduct was not directed at the United States, as he had neither authorized the bribes, nor had any role in the cover-up. Even if Steffen's actions were a proximate cause of the false SEC filings (which the District Court doubted), the District Court found his actions "far too attenuated from the resulting harm to establish minimum contacts [with the United States]." The District Court opined that if it accepted the SEC's elastic view of jurisdiction, then "*every* participant in illegal action taken by a foreign company subject to US securities laws would be subject to the jurisdiction of US courts no matter how attenuated their connection with the falsified financial statements" (emphasis in original). The District Court disapproved, finding that the "exercise of jurisdiction over foreign defendants based on the effect of their conduct on SEC filings is in need of a limiting principle." Under that "limiting principle," the District Court declined the SEC's request to exercise jurisdiction over Steffen.

SEC v. Sharef, et al., No. 11 Civ. 9073 (SAS) (S.D.N.Y. February 19, 2013).

BANKING

Deposit Insurance Coverage Seminars for Bank Officers and Employees

On February 21, the Federal Deposit Insurance Corporation announced that it will conduct 15 free telephone seminars on deposit insurance coverage for bank officers and employees between March 20 and December 3, 2013. Eleven sessions entitled "FDIC Comprehensive Seminar on Deposit Insurance Coverage for Bankers" will provide an overview of the rules for determining deposit insurance coverage for all account ownership categories. Four separate sessions entitled "FDIC Seminar on Revocable Trust Accounts for Bankers" will focus primarily on the rules and coverage for formal revocable trust accountholders whose trust deposits at one bank exceed $1,250,000.

Read more.

Federal Reserve Board Extends Comment Period to Implement Enhanced Prudential Standards and Early Remediation Requirements Until April 30, 2013

Due to "the range and complexity of the issues addressed in the rulemaking," the Federal Reserve Board (Board) has extended until April 30, 2013, the comment period on a proposed rule to implement the enhanced prudential standards and early remediation requirements established under sections 165 and 166 of the Dodd-Frank Wall Street Reform and Consumer Protection Act for foreign banking organizations and foreign nonbank financial companies supervised by the Board. The enhanced prudential standards include risk-based capital and leverage requirements, liquidity standards, risk management and risk committee requirements, single-counterparty credit limits and stress test requirements.

The Board extended the comment period to allow interested persons more time to analyze the issues and prepare their comments. Originally, comments were due by March 31.

Read more.

UK DEVELOPMENTS

FSA Updates Guide to the New PRA and FCA Handbooks

On February 19, the UK Financial Services Authority (FSA) published an updated "one-minute guide" summarizing the changes to the FSA Handbook that will come into effect when the FSA's two successor regulatory bodies, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA), acquire their legal powers on April 1.

The guide confirms that the FSA intends to publish the FCA and the PRA Handbooks during March. The FSA expects to publish the designation and editorial changes online in early March. The remaining substantive changes that have been subject to FSA consultation will be published later in March, together with the relevant FCA and PRA Policy Statements.

The new FCA and PRA Handbooks will reflect the new regulatory regime (for example, references to the FSA will be replaced with the appropriate regulator). In some areas more substantive changes will be made to reflect the existence of the two regulators and their roles and powers as successors to the FSA. This will include the future processes for obtaining permissions, passporting, controlled functions, threshold conditions and enforcement powers.

Read more.

EU DEVELOPMENTS

ESMA Recommends Proxy Advisor Code of Conduct

On February 19, the European Securities and Markets Authority (ESMA) published a Feedback Statement on its March 2012 consultation on the role of the proxy advisory industry as service providers to institutional investors with holdings in European-listed companies.

ESMA concluded that there was no clear evidence of current market failures relating to the actions of proxy advisors. Accordingly, ESMA will not impose a regulatory regime on the proxy advisory industry at this time. However, ESMA advised that the proxy advisory industry develop an industry code of conduct, since there were a number of concerns identified regarding potential conflicts of interest and the independence of proxy advisors and also relating to the accuracy and reliability of the advice that they provide. In the Feedback Statement, ESMA encouraged that the general considerations and principles for the code of conduct focus on:

- identifying, disclosing and managing conflicts of interest; and
- fostering transparency to ensure the accuracy and reliability of advice.

ESMA will review the development of the industry code of conduct in February 2015 at which time it may decide to impose regulatory measures.

Read more.

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